ISLAMIC BANKING AND INTEREST

A Study of the Prohibition of Riba and its Contemporary Interpretation

BY

ABDULLAH SAEED

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ACKNOWLEDGMENTS

I would like to express my sincere gratitude to the University of Melbourne for awarding me a postgraduate scholarship, without which this study would not have been accomplished. The University also provided generous funds for a much needed trip to Egypt, Jordan, UK and Pakistan to collect data for the study. My sincere gratitude and deep appreciation also go to a very special friend, Ibrahim Latheef, without whose moral and material support this study would not have been possible.

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INTRODUCTION

'Islamic banking' is now a widely-known term in both the Muslim world and the West. It denotes a form of banking and finance which attempts to provide services to clients free from 'interest'. The proponents of Islamic banking argue that interest is *riba* and, as such, is prohibited under Islamic law. This attitude towards interest has led several Muslim scholars and financiers to find ways and means of developing an alternative banking system which would comply with the injunctions of Islamic law, in particular, the rulings related to the prohibition of *riba*.

Since the mid 1970s, Islamic banks have been growing at a surprisingly fast rate. These banks were established not only in countries where Islam is the majority religion like Egypt, Jordan, Sudan, Bahrain, Kuwait, United Arab Emirates, Tunisia, Mauritania and Malaysia, but also in the United Kingdom, Denmark and the Philippines, where it is a minority religion. An international Islamic bank, the Islamic Development Bank, whose shareholders are members of the Organisation of Islamic Conference (OIC), acts as the sponsor of Islamic banking and finance in the wider Muslim world. This is in addition to the major efforts made in the early 1980s by Pakistan and Iran to transform their entire financial systems to interest-free ('Islamic') systems.

Overview of the issues

The theory of Islamic banking, which has been in the process of development since the 1950s, maintains that Islamic banking is interest-free banking based on the concepts of *muḍāraba* and *mushāraka*, that is, Profit and Loss Sharing (PLS). Islamic banking theorists and the Muslim legists who contributed to this theory interpreted *riba* as 'interest' and 'predetermined return on capital', particularly financial capital. They believed that a reinterpretation of the traditional definition of *riba* as developed in Islamic law was out of the question, based on the idea of the immutability and permanence of *sharī'a* rules.

By interpreting *riba* as interest, Islamic banking theorists are following the early concept that any benefit which accrues to the lender in a loan is *riba*. Based on this view, any increase (nominal or real) in a loan which accrues to the creditor would be *riba*. The acceptance of this interpretation would not allow an Islamic bank to accept any predetermined return on capital in a loan/debt transaction. To put this interpretation into practice, Islamic banks would have to reject, at least in theory, all the transactions

and contracts which involved an *explicit* interest element in a *legal* sense. Thus, fixed and variable interest-based transactions, bonds and so on would be rejected. But the transactions in which the interest element was not explicit, or was known by a name other than interest, as in the case of currency options, forward contracts and currency swaps, short-term commercial operations under the names of *muḍāraba*, *mushāraka* and *murābaḥa*, would be wholeheartedly accepted under the guise of 'fees', 'commissions' and 'profit'. This has been accomplished by putting more emphasis on the legal definition of contracts and transactions, and by emphasising the *literal* meaning of related *sharī'a* texts on the issue of *riba*.

The divergence of theory from practice is evident on several other fronts. One instance is the denunciation of the concept of the time value of money on the one hand, and on the other, its utilisation on a large scale in the calculation of various 'profit' margins and returns on their advances [chapter 5]. Theorists like Qureshi (1974), Uzair (1978) and Siddiqi (1983a) envisaged that it was Profit and Loss Sharing (PLS) which was to be the main characteristic of Islamic banking financing operations. Any other business of the bank was supposed to be merely subsidiary, and all predetermined return based financing was regarded with suspicion, if not with hostility. However, Islamic banks discovered that they could not use PLS as their main method of financing. Even in financing methods where the name of PLS is used, it generally occurs in the areas of short-term commercial operations hardly different from predetermined return based financing, such as speculative forms of investment in foreign currency, precious metals and commodities in the international markets or in real estate, rather than investment in productive ventures with clients, as envisaged by the theorists.

The growing influence of neo-Revivalism in the Muslim world led the Islamic banking theorists as well as practitioners to hold steadfastly to the traditional interpretation of *riba*. In fact, many contributors to Islamic banking theory as well as many of those who implemented it from the 1960s onwards, appear to have been sympathisers of the two highly influential neo-Revivalist groups: *al-Ikhwān al-Muslimūn* (Muslim Brotherhood) of Egypt and *Jamā'at Islāmi* (Islamic Party) of Pakistan. The neo-Revivalist emphasis on the permanence and immutability of the rulings or instructions given in the Qur'ān and *sunna* appears to have been the main reason why the theorists, as well as the practitioners, were not inclined to advocate any argument in favour of a fresh look at the interpretation of *riba* despite the conceptual and practical difficulties involved in its current interpretation.

The fact of the matter is that the traditional interpretation of *riba* which has been wholeheartedly accepted by the neo-Revivalists faces insurmountable obstacles in today's financial and economic environment as it does not appear to be either totally implementable or morally justifiable. Some of

the most important mechanisms devised by the Islamic banks to implement this interpretation do not appear to be superior to what they have rejected as involving *riba*. One may perhaps regard some of these mechanisms as modern versions of traditional stratagems (developed in Islamic law in the early period of Islamic legal history) to bridge the gap between theory and practice in many areas of Islamic law, including the laws related to *riba*.

The need for such stratagems arises from the conceptual and practical difficulties involved in the current interpretation of *riba*. Any correction to the course of Islamic banking may not perhaps be possible without a fresh look at this concept based on the overall instructions of the Qur'ān and *sunna*, and in the light of contemporary economic and financial realities such as institutional set-up, investment opportunities, institutional arrangements for risk diversification and minimisation, and division of labour.

Objective of the study

The main objective of this study is to assess critically the traditional interpretation of *riba* in Islam, which is the *raison d'être* of Islamic banking, and to highlight the importance of re-examining this interpretation in the light of the moral and humanitarian emphasis on the issue of *riba* as indicated in or understood from the Qur'ān and *sunna*. In dealing with this question, the study attempts to:

- investigate the issue from a moral standpoint rather than the legalistic one which is prevalent in the literature on Islamic banking;
- highlight several problems in Islamic banking practice, which appear to be the result of the unsuitability and inadequacy of the traditional interpretation of *riba*, and also shed light on the legalistic nature of several critical issues relating to Islamic banking;
- identify where Islamic banking is being led by its practices as well as what guidance is available to it from religious consultants, and to argue for approaching the issues of banking and finance on the basis of *ijtihād* not *taqlīd*.

The study will be divided into an introduction, eight chapters and a conclusion. Chapter 1 will examine the relationship between historical background and Islamic banking theory, and the factors which have led to the emergence of Islamic banks in the Middle East from the 1960s onwards, focusing on religious, economic and political factors, with a brief review of the growth of Islamic banks in the 1970s and early 1980s.

Chapter 2 discusses the prohibition of *riba* in the Qur'ān, *sunna* and Islamic law *(fiqh)*. The focus will be on the identification of the features of *riba* as prohibited in the Qur'ān, utilising the earliest available historical

material in the sources of Qur'ānic exegesis and *ḥadīth* literature. It examines also the concept of *riba* in the *sunna* and Islamic law before drawing attention to the use of stratagems *(ḥiyal)* to circumvent these prohibitions.

Chapter 3 deals with the modern controversies surrounding the interpretation of *riba* focusing on Modernist and neo-Revivalist views.

Chapter 4 examines means by which the Islamic banks have transformed the two PLS (Profit and Loss Sharing) concepts of *muḍāraba* and *mushāraka* into mechanisms which in practice resemble that of predetermined return-based financing.

Chapter 5 examines the fixed, predetermined, return-based financing now widely practised by Islamic banks on the basis of *murābaḥa.*

Chapter 6 investigates briefly the claim that the majority of Muslims stay out of the banking system because of their conviction that interest is prohibited. It also examines the stand taken by the Islamic banks on several key issues relating to the banker-depositor relationship, suggesting possible inequity towards the depositors because of this stance.

Chapter 7 investigates the issue of imitation and innovation in Islamic banking by examining the legal opinions published by two Islamic banks: the Jordan Islamic Bank and the Kuwait Finance House.

Chapter 8 is a critique of both the interpretation of *riba* as accepted in Islamic banking, and the method followed by Islamic banks to ensure the islamicity of their system. The chapter argues the need for fresh *ijtihād* to rethink the interpretation of *riba*. It also argues that there *is* the possibility of looking afresh at the issue of *riba* and related rulings, in the light of modern social, economic, legal, and institutional realities.

The study relies heavily on the works of Islamic banking theorists, practising bankers, and documents published by Islamic banks such as the Faisal Islamic Bank of Egypt, the Jordan Islamic Bank, the International Islamic Bank for Investment and Development of Egypt, the Kuwait Finance House and the Dubai Islamic Bank. When the study uses the term 'Islamic banks' in the course of discussion, it must, however, be read cautiously to avoid any over-generalisation. However, it is assumed that these Islamic banks from such diverse backgrounds are to a large extent representative of the private sector commercial Islamic banks currently operating in the Middle East and elsewhere.

In the transliteration of Arabic terms, the following have been ignored: *hamza* (') at the beginning of a word, the long vowel at the end of a word, that is, the macron on a, i and u, and the *tā' marbūṭa.*

CHAPTER ONE

DEVELOPMENT OF ISLAMIC BANKS

This chapter provides a historical background to the issue of *riba* and the emergence and development of Islamic banks in modern times. We first of all trace briefly the process of Islamic revivalism, identifying periods of stagnation and growth in Islamic thought. Finally, religious, political and economic factors that underlie the development of modern Islamic banking systems are identified.

Islamic revivalism

Revivalism, alternatively known as *tajdīd,* is a process by which the Muslim community *(umma)* reinvigorates its social, moral and religious fabric by a return to the fundamentals of Islam, namely the Qur'ān and the *sunna* of the Prophet. The Muslim community, like any other community, has had intermittent cycles of growth and decline, followed by reinvigoration by means of internal moral-social reform.[1] However, later medieval centuries generally saw a marked decline, indeed a stagnation, of intellectual life in the Muslim world.[2] After the crystallisation of the classical schools of Islamic law, independent inquiry and innovation among Muslim jurists gradually declined from about the eleventh century AD. The extreme rationalism and intolerant attitudes of some Muslim jurists and philosophers created their own antithesis, a reactionary trend towards over-organisation, traditionalism, and social and legal rigidity. After the eleventh century AD, the Muslim higher education system also suffered a momentous qualitative distortion: domination of education by sectarian dogmatic theological instruction, that is, the *sharī'a* sciences, at the expense of natural and social sciences, or rational sciences.[3] The destruction of culturally important parts of the then Muslim world by Mongols during the thirteenth century, with the resulting political anarchy and socio-cultural chaos due to the heavy losses of men of learning, engendered further social disintegration and lawlessness. According to the Indo-Pakistani philosopher poet, Muhammad Iqbal,

> ...for fear of further disintegration, which is only natural in such a period

[1] Examples of revivalists include, al-Ghazāli (d.1111), Ibn Taymiyya (d.1328), Aḥmad Sirhandi (d.1624), Muḥammad b. 'Abd al-Wahhāb (d.1792), and Shāh Waliullāh Dihlawi (d.1762).
[2] Rahman, *Islam and Modernity,* p.45.
[3] Husaini, *Islamic Environmental Systems,* pp.18-21.

> of political decay, the conservative thinkers of Islam focused all their efforts on the one point of preserving a uniform social life for the people by a jealous exclusion of all innovations in the law of *sharī'a* as expounded by the early doctors of Islam. Their leading idea was social order.[4]

The intellectual output of the Muslim scholars from the fourteenth century onward could be characterised generally as ponderous and repetitive, unoriginal, pedantic, and superficial.[5]

During the eighteenth and nineteenth centuries, Islamic revivalism began to emerge throughout the Muslim world, against the corruption of religion and the moral laxity and degeneration prevalent in Muslim society. The revivalism of this period[6] is characterised by the following: (i) deep concern with the social and moral degeneration of Muslim society; (ii) a call to a 'going back' to the original Islam and shedding of the superstitions inculcated by popular forms of Sufism and (iii) attempts to get rid of the idea of the fixity and finality of the traditional schools of law, and attempts to perform *ijtihād*, that is, to rethink for oneself the meaning of the original message.[7]

Revivalism in this period led to several influential movements, the most important of which, for our purpose, are the Modernist movement on the one hand, and the neo-Revivalist movement on the other. The following discussion is an attempt to identify the major characteristics of these two movements as they are important to an understanding of the arguments presented in this study.

Modernism

Broadly speaking, the Modernist movement emerged in the latter part of the nineteenth century. It called for fresh attempts to revive *ijtihād*, to derive relevant principles from the Qur'ān and authentic *sunna*, and to formulate necessary laws based on these principles. Modernists criticised what they called the 'atomistic' approach to deriving rules from the Qur'ān and also the early jurists' failure to understand its underlying unity. The Qur'ān, according to the Modernists, was a phenomenon that occurred in the light of history and against a socio-historical background. They saw it as a response to that situation consisting, for the most part, of moral, religious, and social pronouncements in answer to specific problems confronted in concrete his-

[4] Iqbal, *The Reconstruction*, p.151.
[5] Rahman, *Islam and Modernity*, p.45.
[6] Muḥammad b. 'Abd al-Wahhāb (d.1792) began his so-called "Wahhābi" movement, in Arabia. In Yemen, Muḥammad b. 'Ali al-Shawkāni (d.1834) represented an expression of intellectual revival. Shāh Waliullāh (d.1762) and Sayyid Aḥmad of Rae Bareli in India, Ḥājji Shari'at Allah in Bengal (born 1764 circa), Muḥammad b. 'Ali al-Sanūsi (d.1859) were also among the leading 'revivers' of this period.
[7] Rahman, "Islam: Challenges and Opportunities", p.317.

torical situations. According to the Modernists, to insist on a literal implementation of the rules of the Qur'ān, shutting one's eyes to the social change that has occurred and is so palpably occurring, was tantamount to deliberately defeating its socio-moral purposes and objectives.[8] The Modernists also called for the following: (i) selective use of the *sunna*; (ii) the exercise of systematic original thinking with no claim to finality; (iii) a distinction to be made between the *sharī'a* and *fiqh;* (iv) the avoidance of sectarianism; and (v) a reversion to the characteristic methodology but not necessarily to the law and solutions of the classical schools, extinct and extant.[9]

Neo-Revivalism

Neo-Revivalism, which began as an influential movement in the first half of the twentieth century, is in part a continuation of the revivalism of the nineteenth century and early twentieth century, as well as a reaction to the excesses of secularism in the Muslim world.[10] Neo-Revivalism focused *inter alia* on the following important issues: resistance to the 'Westernisation' of the Muslim community (*umma*), advocation of the self-sufficiency of Islam and of Islam as a way of life, and the rejection of any reinterpretation of the Qur'ān or *sunna*.[11] The most important neo-Revivalist movements appeared in Egypt and the Indian subcontinent: the Muslim Brotherhood founded by the Egyptian activist and reformer Ḥasan al-Banna (d.1949), and the *Jamā'at Islāmi* (Islamic Party) founded by the Pakistani scholar Abu al-A'la Mawdūdi (d.1979). This, however, does not mean that neo-Revivalism is restricted to these two groups.

Neo-Revivalism, in its quest to show the relevance of Islam to today's society, as well as to show the superiority of Islam over Western institutions and thought, had to focus initially on the negative aspects of Western civilisation such as alleged moral decadence, capitalist greed, materialistic lifestyle and atheism under communism. The neo-Revivalists argued that Western civilisation was on the verge of collapse, and therefore, that Muslims did not have any need to reject Islam and accept the values, ideas and systems of a 'bankrupt' civilisation. They argued that Islam, as a God-given religion and founder of a brilliant civilisation, had answers for all

[8] Rahman, *Islam and Modernity*, pp.2-19.
[9] Ramdan, *Islamic Law*, pp.71-3; Mahmassani, *Falsafat al-Tashri'*, pp.51ff, 92-8; Iqbal, *The Reconstruction*, pp.129, 151ff, 171-3; Husaini, *Islamic Environmental Systems*, p.23.
[10] Secularism, mostly led by Western-educated elites, emphasised themes of liberalism, freedom, initiative and opportunity at the individual level, and modern science and technology at the collective level. The tendency among the secularists was to absorb all that was good from the West including its political ideas, its economic organisation, its educational system and its technology while retaining Islam mainly in the form of rituals and rules of personal conduct. Muzaffar, "Islamic Resurgence", pp.10, 12.
[11] Ibid., pp.9-12.

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[11] Ibid., pp.9-12.

the modern day ills of both the East and the West.[12] Their idea, that Islam was self-sufficient, was successful in maintaining the morale of the masses and their identity as Muslims.

Both the Muslim Brotherhood and the *Jamā'at Islāmi* advocated that society should be organised on the basis of the Qur'ān and the *sunna* of the Prophet, a theme common in the writings of Ḥasan al-Banna (1978), Mawdūdi (1986, 1988) and their followers such as Sayyid Quṭb (1961), Muḥammad Quṭb (1965) and 'Abd al-Qādir 'Awda (1967). This means that the values, principles, rules and regulations contained in the Qur'ān and the *sunna* should be upheld in all spheres of life, be it social, political, economic, educational, legal or administrative. According to the Malaysian scholar and social activist Chandra Muzaffar, "fundamental to this belief is an explicit recognition that the Qur'ān and *sunna* lay out a complete way of life whose sanctity and purity should not be tarnished by new interpretations influenced by time and circumstances."[13]

Based on the above, the function of *ijtihād*, according to the neo-Revivalists, would be to arrive at solutions to problems not explicitly covered by the Qur'ān and the *sunna*. In line with this mode of thinking, they emphasised areas such as Qur'ānic punishments (*ḥudūd*), family laws based on the Qur'ān and *sunna*, and also identified interest on loans as *riba*.[14] According to the neo-Revivalists, no rule stated in the Qur'ān or *sunna* is to be reinterpreted or modified. Muslims need to accept them and apply them without modification irrespective of time, place and level of social or economic development. The statement often found in neo-Revivalist writings, that the *sharī'a* is good for all times and places, emphasises this point.

Even though both Modernism and neo-Revivalism have been influential in shaping Islamic thought in modern history, it is the neo-Revivalist movement which has been the most influential in the development of Islamic banking theory. This theory was largely developed in order to put into practice the traditional interpretation of *riba* (embraced by the neo-Revivalists) in the area of banking and finance.

Factors which led to the emergence of Islamic banks

Although many factors appear to have led to the emergence of Islamic banks in the 1960s and 1970s, the most important of them could be said to be the following: (i) neo-Revivalist condemnation of interest as *riba*; (ii) the oil-wealth of conservative Gulf states; and (iii) the adoption of the traditional interpretation of *riba* by several Muslim states at policy-making level.

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[12] See for instance, Quṭb, *al-Insān bayna al-Māddiyya wa al-Islām*; Mawdūdi, *al-Ḥaḍārat al-Islāmiyya*.
[13] Muzaffar, "Islamic Resurgence", p.10.
[14] Rahman, "Islam: Challenges and Opportunities".

Neo-Revivalist condemnation of interest as riba. In the nineteenth century, Western interest-based banks began to be established in the Muslim world. These banks did not remain unchallenged. While some leading figures like Muḥammad Rashīd Riḍa (d.1935), the famous disciple of Muḥammad 'Abduh (d.1905), attempted to accommodate some forms of interest,[15] the progress of Islamic revivalism in the nineteenth and twentieth centuries led many *'ulamā'* (scholars of religion) and reformers to resist the interest-based banks and their services. In Egypt, from the 1930s onwards, the influential Muslim Brotherhood began to voice its criticism of the interest-based financial system in Egypt and other parts of the Muslim world. The Muslim Brotherhood argued that since Islam provides Muslims with a comprehensive ideological framework within which to conduct all affairs of life, they should include their economic affairs within that framework. According to the Muslim Brotherhood, since the Qur'ān has prohibited *riba*, (which according to them covers interest), all interest-based activities of both public and private sectors should end. Ḥasan al-Banna (d.1949), the founder of the Muslim Brotherhood, in a letter sent in 1947 to Arab and Muslim heads of state, urged them, *inter alia*, to reform their banking systems according to the teachings of Islam. Among the reforms he requested them to undertake was the re-organisation of the banks on an interest-free basis: "Let the government provide a good example in this domain by relinquishing all interest due on its own particular undertakings, for instance in the loan-granting banks, industrial loans etc."[16] Sayyid Quṭb, the ideologue of the Muslim Brotherhood, in his interpretation of *riba*-related verses in the Qur'ān, also condemned bank interest and accused modern banks of "eating the bones and flesh" of the poor borrowers and "drinking their sweat and blood" under the umbrella of the interest-based system.[17] In the Indian subcontinent, the neo-Revivalist *Jamā'at Islāmi*, led by Abu al-A'la Mawdūdi, continued to condemn interest and the interest-based banking system. Mawdūdi himself wrote several works on the issue.[18]

Condemnation of the institution of interest and efforts to develop a model of an interest-free Islamic bank went on simultaneously in the 1950s and 1960s. Although in the earliest works, such as Anwar Iqbal Qureshi's (1967) *Islam and the Theory of Interest*, the discussions on interest-free banking were brief, Mawdūdi's treatise, *al-Riba*, discussed the issue in somewhat more detail. Mohammad Uzair, a pioneer in the theory of Islamic banking, wrote his *A Groundwork for Interest-free Banking* (a summary of which was published in 1955 as *An Outline of Interestless Banking*) which

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[15] Homoud, *Islamic Banking*, pp.115ff.
[16] Banna, *Five Tracts*, p.130.
[17] Quṭb, *Tafsīr Āyāt al-Riba*, p.12.
[18] Mawdūdi, *Riba*; Mawdūdi, *Economic System of Islam;* Mawdūdi, "Prohibition of Interest in Islam".

has been described by M.N. Siddiqi as the first published work exclusively devoted to the subject by a professional economist. In the late sixties, works by writers like the Shī'i scholar Bāqir al-Ṣadr(1973), M.N. Siddiqi (1983a), the Indian economist who wrote several works on Islamic banking, and Aḥmad al-Najjār (1985), the leading figure in the first Egyptian Islamic banking experiment, resulted in a mature and comprehensive model of interest-free banking.[19] The 1970s saw the publication of many works on Islamic banking. M.N. Siddiqi in his survey of Islamic economics mentioned about fifty-five books, articles and reports on the issue of interest written in the 1950s, 1960s and early 1970s, in Arabic, Urdu and English alone. Islamic banking theory was being developed under the influence of neo-Revivalist thinking until Islamic banks began to be established on a large scale in the 1970s, largely due to the huge increase in the revenues of some conservative countries as a result of the oil price rise during that decade.

The oil-wealth of conservative Gulf states. The oil revenue which began to flow into Saudi Arabia, Kuwait, the United Arab Emirates (UAE), Qatar and Bahrain was an important determinant in the development of Islamic banks, although in the literature one finds an uneasiness on the part of some proponents of Islamic banking in acknowledging this fact. For Ausaf Ahmad, for instance, linking the establishment of Islamic banks with prosperity created by increased oil prices is a naive view and does not carry much weight.[20]

Although the earliest Islamic banking experiments like that of Malaysia in the mid 1940s, the Indian *Jamā'at Islāmi* in 1969,[21] Egypt's Mit Ghamr Savings Banks (1963-67) and the Nasser Social Bank (1971) cannot be linked to Arab oil wealth, the accelerated growth of Islamic banks at national and international levels occurred *after* the oil price rises of 1973 and 1974. Almost all Islamic banks established in the 1970s in the Middle East were partly, and in some cases totally, funded by oil-linked wealth. The Islamic Development Bank, whose capital is approximately US$2 billion, has a majority share-holding, that is, more than 60 percent, by the oil-producing Saudi Arabia, Kuwait, United Arab Emirates (UAE) and Libya. The Dubai Islamic Bank, the Kuwait Finance House, the Bahrain Islamic Bank, the Qatar Islamic Bank, the Faisal Islamic Banks of Bahrain, Niger and Senegal, banks of the Al-Baraka group of Shaykh Ṣāleh Kāmil, and Dār al-Māl al-Islāmi (DMI) of the Saudi Prince Muḥammad al-Faisal are totally funded by oil wealth, while the Faisal Islamic Banks of Egypt and of Sudan, and most other Islamic banks in non oil-exporting countries, are partly funded by oil wealth.

[19] Siddiqi, "Muslim Economic Thinking", p.222.
[20] Ahmad, *Development and Problems of Islamic Banks*, p.7.
[21] Khan, *Profit and Loss Sharing*, pp.52-4.

The most active countries in contributing the necessary capital for Islamic banks, at private or public sector levels, were Saudi Arabia, Kuwait and the UAE, the leading oil exporters of the Gulf. This was facilitated by their large revenue increases, especially after their successful negotiations with the oil companies in the late 1960s and early 1970s to increase their share. The four-hundred percent increase in the oil price after the Arab oil embargo of 1973 was also an important determinant in the revenue increase. Saudi Arabia's earnings jumped from a mere US$36 million in 1960, to US$4.3 billion in 1973, and US$55.5 billion in 1979, reaching US$104.2 billion in 1980. Kuwait's revenue increased from a mere US$47 million dollars in 1960, to US$1.9 billion in 1973, US$16 billion in 1979 and US$18.3 billion in 1980. The UAE had a similar progress: in 1973 its oil revenue was US$0.9 billion whereas in 1979 it was US$12.4 billion, and in 1980 it reached US$19.2 billion.[22]

This increase in revenue created large foreign reserves for these countries. The increase was beyond their absorptive capacity, which led to the so-called 'problem' of the recycling of petro-dollars. The process of this recycling was carried out in three main ways: (i) by buying Western consumer goods, military hardware, industrial equipment and other goods; (ii) by investing their funds in development projects at home and abroad; and (iii) by lending/advancing money through official and private channels to oil-less countries.[23] It was apparently through the second and third channels that the oil wealth flowed to establish Islamic banks and other programmes of Arab aid. At inter-Islamic governmental level, the first Islamic bank funded mainly by this oil wealth was the Islamic Development Bank, with a capital of approximately US$2 billion. At private sector level, many wealthy Arab Muslims began their efforts to use this newly acquired wealth to establish Islamic financial institutions. Prince Muḥammad al-Faisal and Shaykh Ṣāleh Kāmil are examples of leading Muslims who played an important role in their establishment.

The adoption of the traditional interpretation of riba by several Muslim states. The two factors examined so far are closely related to the political decisions of the rulers of many Muslim countries, without which Islamic banking would perhaps have existed only in theory. The political decisions relating to its promotion are manifest on three fronts: (i) the prohibition of interest in the laws of some Muslim countries; (ii) the decision to establish an international Islamic bank; and (iii) the participation of Muslim governments in the emerging Islamic banking movement.

The prohibition of interest in the laws of some Muslim countries. The prohibition of interest, on the one hand, found its expression in the civil and

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[23] Ali, *Oil, Turmoil and Islam*, p.33.

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commercial laws of some Muslim states. In the Kuwaiti Civil Code, for example, Article 547 states that "loans shall be without interest. Any condition to the contrary shall be void without prejudice to the loan agreement itself," and that "any benefit stipulated by the lender shall be considered interest."[24] On the other hand, the Kuwaiti Commercial Code allowed interest in commercial loans, and stated that the creditor has a right to receive it: "The creditor has the right to interest in a commercial loan unless the contrary is agreed."[25]

In Saudi Arabia, the charter of the Saudi Arabian Monetary Agency (SAMA), the Saudi central bank, explicitly prohibits SAMA from receiving or paying interest. Article 2 of the charter says: "The Saudi Arabian Monetary Agency (SAMA) shall not pay or receive interest but shall only charge certain fees on services rendered to the public and to the Government, in order to cover the Agency's expenses."[26] In a similar manner, Article 6 states that among the functions the Agency shall not undertake, is, "acting in any manner which conflicts with the teachings of the Islamic law. The Agency shall not charge any interest on its receipts and payments." However, with the toleration of SAMA, the commercial banks in Saudi Arabia, except for the al-Rājiḥis, are conducting their business on the basis of interest. According to Abdeen and Shook:

> Money lending by commercial banks (in Saudi Arabia), however, is often subject to interest charges, a feature that reduces the Islamic influence on the financial system as a whole. This feature has caused many Muslims in Saudi Arabia and other Muslim countries to refrain from keeping their savings in commercial banks because *riba*, or interest, is banned by the Islamic *sharī'a*.[27]

SAMA's toleration can be explained by reference to the Saudi Banking Control Law promulgated by Royal Decree No. M/5 of 22 Ṣafar 1386AH, which is totally silent on the issue of interest.

The decision to establish an international Islamic bank. At inter-governmental level, the first attempt to establish Islamic banks goes back to the efforts of Muslim heads of state to create a united Islamic front, in the face of a perceived danger from Israel and her allies to the sovereignty and dignity of some Muslim countries and societies. Immediately after the burning in 1969 of the al-Aqṣa mosque, the third holiest mosque, several Muslim heads of state, with active encouragement from Saudi Arabia, held a meeting in Morocco to create what later became the Organisation of Islamic Conference (OIC). At this conference it was decided that Muslim governments should consult together with a view to promoting close co-operation

[24] Kuwaiti Civil Code, Articles 543-51.
[25] Ibid., Articles 102, 104-15.
[26] SAMA, *Charter*, Article 2.
[27] Abdeen and Shook, *The Saudi Financial System*, p.21.

and mutual assistance in the economic, scientific, cultural and spiritual fields, inspired by the immortal teachings of Islam.[28]

Following this decision, a number of steps taken by OIC organs led to the establishment of the first international Islamic bank. The first Islamic Foreign Ministers' conference held in Jeddah from 23 to 25 March 1970 and the second in Karachi from 26 to 28 December of the same year, emphasised that there should be coordinated efforts among the Muslim countries to reshape the life of Muslims, deriving inspiration from the historical Islamic cultural roots and based on Islamic teachings.

These two conferences were followed by an important meeting in Cairo from 7 to 9 February 1972 to arrive at an alternative Islamic method of dealing with financial matters, and to find ways of facilitating the investment of the surplus capital of the oil-rich Muslim countries, in a way which would be of benefit to the Muslim community. At this meeting, an important document, *Institution of an Islamic Bank, Economics and Islamic Doctrine*, alternatively known as the *Egyptian Study*, was discussed, and later adopted at the Third Islamic Conference of Foreign Ministers in Jeddah, 1972. According to Wohlers-Scharf, the *Egyptian Study* was instrumental in furthering the development and implementation of Islamic banks with many of its conceptual proposals being adopted.[29]

The *Egyptian Study* seems to have led the late King Faisal of Saudi Arabia to appoint a committee to study the project of the Islamic bank. He also encouraged Tunku Abdul Rahman, the then Secretary General of the Conference of Foreign Ministers of Muslim States, to work towards realisation of the project. Faisal committed his country to providing one-fourth of the capital of the bank (US$500 million approximately), thus becoming a major shareholder.

The *Egyptian Study*, Tunku Abdul Rahman's efforts and King Faisal's active encouragement led to the 'Declaration of Intent' issued by the Conference of Finance Ministers of Muslim Countries held in Jeddah in December 1973, which in turn led to the creation of the Islamic Development Bank.[30] The purpose of this bank is to foster economic development and social progress in member countries and Muslim communities individually as well as jointly in accordance with the principles of the *sharī'a*.[31]

The participation of Muslim governments in the emerging Islamic banking movement. Not only did the Muslim nations became members of the newly created Islamic Development Bank, but some of them also began to promote Islamic banks in their countries, by promulgating special laws and

[28] IAIB, *al-Mawsū'at al-'Ilmiyya*, V, pp.105-8.
[29] Wohlers-Scharf, *Arab and Islamic Banks*, p.77.
[30] IDB (Islamic Development Bank) was opened formally on the 20th of October, 1975.
[31] IDB, *Technical Cooperation*, p.1.

decrees for their establishment, or by becoming shareholders. The Emir of Dubai passed a decree on 12 March 1975 to establish the Dubai Islamic bank; a decree was issued by the Emir of Kuwait on 23 March 1977 to establish the Kuwait Finance House;[32] a law was passed on 4 April 1977 to establish the Faisal Islamic Bank of Sudan and a similar law (No.28) to establish the Faisal Islamic Bank of Egypt was passed in Egypt in 1977.

On the other hand, many Muslim governments became shareholders in the newly created banks. The Nasser Social Bank (1971) is wholly government owned. Kuwait ministries have a forty-nine percent shareholding in the Kuwait Finance House. The Kuwait and Bahrain governments and IDB hold a thirty-seven percent interest in the Bahrain Islamic Bank (1979). The federal government of Malaysia and state religious bodies hold eighty percent of Bank Islam Malaysia. The Bangladesh government holds fifty-one percent of the International Islamic Bank, Bangladesh, and in the Saudi-Tunisian Finance House, the Central Bank of Tunisia holds twenty percent. In Egypt, the government-owned Banque Misr has a large network of Islamic branches throughout Egypt, rivalling the large Faisal Islamic Bank of Egypt.[33] There is perhaps no Muslim government which in one way or another has not dealt with the Islamic banks. Growing confidence in Islamic banking may mean more accommodation of Islamic banks, even by the so-called secular governments of the Muslim countries.

This participation of governments in the Islamic banks is dwarfed by developments in two Muslim nations, namely Pakistan and Iran. These two countries embarked on a wholesale transformation of their economies to interest-free systems. The late Zia-ul-Haq of Pakistan attempted to abolish interest from the Pakistani economy. Iran embarked on the islamisation of its financial system immediately after the Islamic revolution in 1979, and by the mid-1980s, the Iranian banking and financial system was reportedly running on an Islamic basis. In Sudan also, the former President Ja'far Numeiri, with the active participation of and pressure from the Muslim Brotherhood of Sudan, attempted to abolish interest from the economy of that nation. As the Islamic revivalism is gaining ground in almost all Muslim societies, many governments are likely to face pressure from their populations to abolish interest which is perceived to be *riba*.

Growth of Islamic banks

Since the first Islamic banking experiment of Mit Ghamr in the 1960s, Islamic banks have proliferated due to demand on one hand, and the energetic efforts on the other, of leading Islamic banking proponents of the oil-rich Gulf. Islamic banks began to increase in number after their inception in the

[32] Law No.72 (1977).
[33] Annual Reports of the relevant banks.

1960s. From only one bank in the world in the early 1970s, the number increased to nine by 1980. They were the Nasser Social Bank (1971), the Islamic Development Bank (1975), the Dubai Islamic Bank (1975), the Faisal Islamic Bank of Egypt (1977), the Faisal Islamic Bank of Sudan (1977), the Kuwait Finance House (1977), the Bahrain Islamic Bank (1979) and the International Islamic Bank for Investment and Development (1980). Between 1981 and 1985, another twenty-four Islamic banks and finance houses were established in Qatar, Sudan, Bahrain, Malaysia, Bangladesh, Senegal, Guinea, Denmark, Switzerland, Turkey, England, Jordan, Tunisia, and Mauritania. More Islamic banks or financial institutions are being established in almost all Muslim countries. Even in non-Muslim states where significant Muslim minorities exist, like the United States of America or Australia, attempts are being made to set up Islamic financial institutions. In addition to individual banks, the banking systems of Pakistan, Iran and Sudan are apparently running on some Islamic basis.

Concluding remarks

Islamic revivalism, after a long period of stagnation, has produced several trends of thought within Islam in modern times, among which are Modernism and neo-Revivalism. The Modernists attempted to put more emphasis on the moral-spiritual principles of the *sharī'a*, and called for efforts to understand the Qur'ān and *sunna* in the light of these broad principles. Neo-Revivalists, on the other hand, focused on the application of the *sharī'a* as it stood without any fundamental reinterpretation of any of its explicit texts.

The spread of Western-style interest-based banks in predominantly Muslim countries has led Muslim scholars to debate whether or not interest is *riba*. Neo-Revivalists maintain that it is, and have been calling for its abolition since the 1930s, whereas the Modernists argue that not all forms of interest are *riba*, but only those which could be regarded as unjust. Although the voice of the neo-Revivalists was not given much recognition by political leaders prior to the 1960s, it had its effect on the laws of several Muslim countries, which regarded interest as *riba*. Despite this, no Muslim government in modern times attempted to abolish interest prior to the 1970s. The situation, however, changed in the 1970s due to two factors: the growing influence of neo-Revivalism and the oil-wealth of the conservative Gulf countries. The neo-Revivalist interpretation of *riba* as interest was given a boost by the moral and material support of the Gulf rulers and many wealthy citizens of these countries. Millions of dollars were invested in establishing Islamic banks in the Middle East and elsewhere. Concurrently, Islamic governments of Pakistan, Iran and Sudan embarked on eliminating interest from their banking and financial systems. The Islamic banks grew

rapidly in the 1970s and 1980s. At present Islamic banks in one form or another exist in many Muslim and non-Muslim countries. Deposits, advances and shareholders' equity in these banks have risen significantly.

CHAPTER TWO

RIBA IN THE QUR'ĀN, SUNNA AND FIQH

Since the 1960s, the prohibition of *riba* (interest or usury) has been one of the most discussed issues amongst Muslims. This is a consequence of both the perception that bank interest is *riba*, and the prevailing nature of interest in the present world banking system. There are two predominant views concerning *riba*. Many Muslims would contend that the interpretation of *riba* as provided in *fiqh* (Islamic law) is *the* proper interpretation and so must be followed. This interpretation implies that any increase charged in a loan transaction over and above the principal is *riba*. For others, the prohibition of *riba* is understood as relating to the exploitation of the economically disadvantaged in the community by the relatively affluent. This element of exploitation may or may not actually exist in modern bank interest. These Muslims would argue that the interpretation of *riba* in the *fiqh* literature is inadequate and does not take into consideration the moral intent of the prohibition as expounded in, or inferred from, the Qur'ān and *sunna*. This chapter examines the overall context of the prohibition of *riba* in the Qur'ān, the *sunna* and in the *fiqh* literature.

Riba and the Qur'ān

Condemnation and the ultimate prohibition of *riba* in the Qur'ān was preceded by the proscription of several other morally objectionable modes of behaviour towards the socially and economically disadvantaged in the Meccan community. From the earliest time of the Prophet Muḥammad's mission, the Qur'ān encouraged Meccans to help the poor, the needy, and the orphans among others. According to the Qur'ān, those who do not perform prayer (*ṣalāt*) and do not feed the destitute will be punished in Hell.[1] In some other early verses, the Qur'ān states, for instance, that beggars and the destitute have a right to a share of the wealth of the affluent.[2] It castigated the Unbelievers saying that they did not encourage the provision of food and support to the destitute.[3] On many occasions, the Qur'ān condemned the affluent in Meccan society[4] using parables to demonstrate the

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[1] Qur'ān 74:43-4.
[2] Qur'ān 70:24-5.
[3] Qur'ān 69:34.
[4] Qur'ān 89:17-20.

unfortunate consequences of preventing the poor from having a share in the wealth of the rich.[5]

The Qur'ān reiterates the importance of 'spending' (giving) to relieve the suffering of the poor, the needy and the destitute. Terms denoting spending, whose Arabic root is *n-f-q* are mentioned in the Qur'ān about seventy-five times.[6] Other terms for 'spending', such as *zakāt* and *ṣadaqa*, are also used. *Zakāt,* in the sense of 'spending', appears thirty-one times.[7] In all but four cases it is mentioned in conjunction with the command to perform prayers *(ṣalāt),* emphasising the importance of spending. The term *ṣadaqa* is used twelve times.[8] In Qur'ānic terminology, the terms *zakāt* and *ṣadaqa* seem to be synonymous, even though Islamic law later differentiated between them, restricting the former to compulsory spending and the latter to voluntary spending.[9] The emphasis on the giving of money in the very early period of the Prophet's mission indicates its importance. The Qur'ān concerns itself deeply with the weaker strata of the community[10] and insists on the social responsibility of the rich to the economically disadvantaged. There are many instances of the rich being commanded to care for the disadvantaged, and provide financial support for relatives,[11] orphans,[12] debtors,[13] beggars, wayfarers,[14] migrants,[15] prisoners of war,[16] the divorced,[17] the deprived,[18] the destitute,[19] the poor,[20] and slaves.[21] This concern probably ranks close to the importance of the unity of God, God's favours to His creatures, the prophethood of Muḥammad, the revelation and life after death.

The Qur'ān reminds the affluent that wealth is both a trust and a test.[22] Amassing wealth without consideration for the socially and economically disadvantaged will not lead to salvation either in this world or the Hereafter, and has no intrinsic value in the eyes of God.[23] The Qur'ān condemns arrogance and pride in wealth in verses such as "God does not like the haughty

[5] Qur'ān 68:17-33.
[6] Qur'ān 2:262; 4:39; 13:22; 25:67; 35:29.
[7] Qur'ān 2:43,83,110,177,277; 4:77,162; 5:12.
[8] Qur'ān 2:196,263,271,276; 4:114; 9:58,60,79,103,104; 58:12,13.
[9] For instance, the verse which states the recipients of *zakāt* used the term *'ṣadaqāt'* for *'zakāt'*.
[10] Watt, *Mohammad at Mecca*, pp.60-72.
[11] Qur'ān 8:41.
[12] Qur'ān 2:177,220; 8:41; 76:8-9.
[13] Qur'ān 9:60.
[14] Qur'ān 2:177; 8:41; 9:60.
[15] Qur'ān 24:22.
[16] Qur'ān 76:8-9.
[17] Qur'ān 2:236.
[18] Qur'ān 51:19; 70:19-25.
[19] Qur'ān 8:41; 76:8-9.
[20] Qur'ān 2:271; 9:60.
[21] Qur'ān 2:177; 9:60; 58:3.
[22] Qur'ān 2:155; 3:186; 8:28.
[23] Qur'ān 34:37.

and arrogant."[24] The Qur'ān also reminds us that God has destroyed many rich people for their arrogance and their lack of concern and fellow-feeling for the poor and needy.[25] It also severely condemns greed[26] asserting that the rich must overcome selfishness and greed in order to attain salvation.[27]

The Qur'ān makes spending (that is, giving to the needy) obligatory by means of *zakāt* while maintaining that Muslims should give voluntarily and generously in any situation that demands intervention to reduce the misery and suffering of a person or a group. Having established this in lucid terms, it goes on to declare that those who hoard money and do not give will earn a severe punishment.[28] It further states that spending for the sake of God is like a business which suffers no loss.[29] It also maintains that spending facilitates one's spiritual purification.[30] One of the most important qualities of good Muslims is that they spend for the sake of God. Furthermore, the donor should not cause any distress to the recipient[31] by mentioning the donation at a later time. Spending should not be used to parade one's generosity or to enhance one's fame, glory or reputation.[32] However, spending does not mean that one should disburse wealth foolishly. According to the Qur'ān, "Spendthrifts are brothers of Satan."[33]

Spending can be in the form of a gift or donation. Where such a donation is difficult, a loan could be made without imposing any extra charges or other burden on the needy person. Such a loan is referred to in the Qur'ān as *qarḍ ḥasan* (a benevolent loan).[34] These loans are advanced for the sake of God to relieve the suffering of the disadvantaged, not to exploit them. The contexts of all verses where the Qur'ān has used the term *qarḍ ḥasan* indicate that the recipients of such loans would generally be the disadvantaged.[35] In one such verse, the Qur'ān says:

> And why should you not spend freely in the cause of God, seeing that God's alone is the heritage of the heavens and the earth?...Who is it that will offer up unto God a benevolent loan [*qarḍ ḥasan*] which He will amply repay?[36]

If on maturity of this *qarḍ ḥasan* the debtor is experiencing hardship and is unable to pay, no extra charges or any form of interest should be imposed.

[24] Qur'ān 57:24.
[25] Qur'ān 17:16; 23:64; 28:58; 28:81.
[26] Qur'ān 57:24.
[27] Qur'ān 59:9; 64:15-16.
[28] Qur'ān 9:35.
[29] Qur'ān 35:29.
[30] Qur'ān 8:72; 49:15.
[31] Qur'ān 2:262,263.
[32] Qur'ān 2:264; 4:38.
[33] Qur'ān 17:26-7.
[34] Qur'ān 2:245.
[35] Qur'ān 2:245; 5:12; 57:11,18; 64:17.
[36] Qur'ān 57:10-11.

On the contrary, the debtor should be given time until he is able to repay the loan. According to the Qur'ān the best course of action would be to forgo even the principal and so relieve the suffering of the debtor altogether if the creditor can afford to do so. The Qur'ān says: "It is better if you give [even the principal] as charity."[37]

The above shows the concern of the Qur'ān with the economically disadvantaged in society, and highlights the need for the provision of financial assistance to them without adding to their suffering. The context of these and similar verses indicates that such a course of action is recommended in the case of such debtors who are compelled to borrow to meet basic needs. There is nothing to indicate that this course of action should be taken in the case of lending and borrowing among the affluent for trade or commercial purposes, in other words for non-humanitarian purposes.

The term 'riba' as used in the Qur'ān. The root *r-b-w* from which *riba* is derived, is used in the Qur'ān twenty times.[38] Of these the term *riba* is used eight times.[39] The root *r-b-w* has the sense in the Qur'ān of 'growing',[40] 'increasing',[41] 'rising', 'swelling',[42] 'raising',[43] and 'being big and great'.[44] It is also used in the sense of 'hillock'.[45] These usages appear to have one meaning in common, that of 'increase', in a qualitative or quantitative sense.

The first verse containing the term *riba* appears to have been revealed in the very early period of the Prophet's mission in Mecca, most probably in the fourth or fifth year (that is, AD 614 or 615), or perhaps somewhat earlier. This dating is based on the internal evidence of the Qur'ān.[46] The verse reads:

> And, whatever you may give out in *riba* so that it may increase through other people's wealth, does not increase in the sight of God; but whatever you give by way of charity seeking God's pleasure, will receive manifold increase.[47]

After referring to the differences in people's wealth in the previous verses,[48] the Qur'ān goes on to command Muslims to provide financial support to

[37] Qur'ān 2:280.
[38] Qur'ān 2:265,275,276,278; 3:130; 4:161; 13:17; 16:92; 17:24; 22:5; 23:50; 26:18; 30:39; 41:39; 69:10.
[39] Qur'ān 2:275,276,278; 3:130; 4:161; 30:39.
[40] Qur'ān 22:5.
[41] Qur'ān 2:276; 30:39.
[42] Qur'ān 13:17.
[43] Qur'ān 17:24; 26:18.
[44] Qur'ān 16:92.
[45] Qur'ān 2:265; 23:50.
[46] Rahman, "Riba and Interest", p.3.
[47] Qur'ān 30:39.
[48] Qur'ān 30:37.

those in need, including one's relatives, the destitute, and wayfarers.[49] This support should be on the basis of charity rather than of *riba*. It is those who give on the basis of charity who will have their reward manifold in this world or the Hereafter.[50]

Several early commentators on the Qur'ān contended that the meaning of *riba* in this verse was 'gift'. Based on this interpretation, some lexicographers like Azhari (d.370/980)[51] and Ibn Manẓūr (d.711/1311)[52] stated that there were two forms of *riba*, one prohibited and the other lawful. According to Ibn Manẓūr, this verse[53] refers to 'lawful' *riba*. He explained it by saying that lawful *riba* is "giving a person something in anticipation of getting something better at a later time."[54] The interpretation of *riba* as 'gift', however, is rather problematic. All usages of the term *riba* in the Qur'ān appear to have the same meaning, that is, a charge imposed on a needy debtor due to his inability to repay a debt on time. The term *riba* in the sense of gift does not appear to have been used in pre-Islamic or post-Islamic times. Neither Azhari nor Ibn Manẓūr provides any examples of such a usage. It could, therefore, be argued that the concept of a lawful *riba* and an unlawful *riba* was most probably a later invention due to the difficulty the commentators had in interpreting the rather unusual wording of the verse (30:39) in which the term is used. The Qur'ān here appears to be condemning the practice of *riba* and the resulting exploitation of the disadvantaged in the Meccan community.

The condemnation of *riba* in the very early period of the Prophet's mission appears to be consistent and contemporaneous with the Qur'ānic concern for the less fortunate. The late Pakistani scholar Fazlur Rahman stated:

> It is not at all surprising that *riba* is condemned in so early a revelation; rather the absence of such early condemnation could have [*sic*] not only been surprising but also contrary to the wisdom of the Qur'ān. The Meccan verses of the Qur'ān are replete with the denunciation of the economic injustice of contemporary Meccan society, the profiteering and stinginess of the rich, and their unethical commercial practices such as cheating in the weights and measurements, etc. How is it possible, then, that the Qur'ān would have failed to condemn an economic evil such as *riba*?[55]

The second *riba*-related verse appears to have been revealed in Medina, immediately after the battle of Uḥud (3/625) and almost eleven years after the first condemnation of the *riba* in Mecca:

[49] Qur'ān 30:38.
[50] Qur'ān 30:39.
[51] Azhari, *Tahdhib*, XV, p.273.
[52] Ibn Manẓūr, *Lisān*, XIV, p.304.
[53] Qur'ān 30:39.
[54] Ibn Manẓūr, *Lisān*, p.304.
[55] Rahman, "Riba and Interest", p.3.

> O Believers! Do not consume *riba*, doubling and redoubling, and fear God so that you may prosper.[56]

The verse is in the context of a reminder to Muslims of what went wrong in the battle of Uḥud, when a potential victory was turned to a grave defeat, resulting in the death of seventy Muslim men who left behind orphans, widows, and aged parents in need of financial support and assistance.[57] Such a situation required that assistance be provided to those in need on the basis of charity, not of *riba*. Thus, immediately after declaring that Muslims should not engage in *riba* transactions, the Qur'ān commanded them to be God-conscious, to fear Hell, to obey God and the Prophet and to hasten for forgiveness from God, describing the God-conscious as those "who spend in prosperity and adversity"[58] to relieve the suffering of the needy.

This verse (3:130) unequivocally prohibits *riba* by saying "Do not consume *riba*."[59] Explaining the meaning of the term as used in verse 3:130, Ṭabari (d.310/923), the well-known commentator on the Qur'ān, says:

> Do not consume *riba* after having professed Islam as you have been consuming it before Islam. The way pre-Islamic Arabs used to consume *riba* was that one of them would have a debt repayable on a specific date. When that date came the creditor would demand repayment from the debtor. The latter would say, 'Defer the repayment of my debt; I will add to your wealth.' This is the *riba* which was doubled and redoubled.[60]

The way in which *riba* was doubled and redoubled in the pre-Islamic period is expressed by the son of Zayd b. Aslam (d.136/754)[61] as follows:

> *Riba* in the pre-Islamic period consisted of the doubling and redoubling [of money or commodities], and in the age [of the cattle]. At maturity, the creditor would say to the debtor, 'Will you pay me, or increase [the debt]? If the debtor had anything, he would pay. Otherwise, the age of the cattle [to be repaid] would be increased... If the debt was money or a commodity, the debt would be doubled to be paid in one year, and even then, if the debtor could not pay, it would be doubled again: one hundred in one year would become two hundred. If that was not paid, the debt would increase to four hundred. Each year the debt would be doubled.[62]

As this report indicates, even if the debt was "a small amount, it can consume all the wealth of the debtor"[63] by "repeated increases"[64] due to the inability of the debtor to repay as agreed.

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[56] Qur'ān 3:130.
[57] Ibn Hishām, *al-Sirat al-Nabawiyya*, II, pp.122-9.
[58] Qur'ān 3:134.
[59] Ibn Kathīr, *Tafsir*, I, p.412.
[60] Ṭabari, *Jāmi'*, IV, p.59.
[61] Ibn Ḥajar, *Tahdhib*, III, p.395.
[62] Ṭabari, *Jāmi'*, IV, p.59.
[63] Zamakhshari, *Kashshāf*, p.234.
[64] Bayḍāwi, *Tafsir*, p.56.

The reports relating to pre-Islamic *riba* in the exegetical literature appear to imply that the normal practice among pre-Islamic Arabs in Ḥijāz was for a creditor not to demand an increase in the principal at the time the loan was advanced or the debt occurred. Rather, the increase was imposed on the debtor at maturity upon the debtor's inability to pay the principal on time. In his attempt at reconstructing how *riba* was practised in the pre-Islamic period, Ṭabari, in his interpretation of verse 3:130, says:

> The pre-Islamic Arabs' consumption of *riba* was as follows: a creditor would have a debt payable to him by a debtor. Upon maturity of the debt the creditor demands repayment of the debt.[65]

Ibn al-'Arabi (d.543/1148), who also commented on the Qur'ān, is of the same view:

> *Riba* was well known among the Arabs. A person would sell something on a deferred payment basis. Upon maturity the creditor would say [to the debtor]: 'Will you pay [as agreed] or will you add an amount to the [original] debt?'[66]

These reports indicate that the *riba* as practised in the pre-Islamic period *(riba al-jāhiliyya)* involved adding an amount to the principal against an extension of the maturity of an existing debt due to the debtor's inability to repay on time. None of the reports quoted by Ṭabari, one of the earliest exegetical sources available to us, suggests that any increase was added at the time the debt was contracted. All reports available suggest that the increase in the debt occurred *after* the contract was concluded *and* at the maturity date and was due to the inability of the debtor to meet his obligation. These reports refer to debts but do not reveal whether they were the result of loans or deferred payment sales. A contrasting view was expressed by the Ḥanafi jurist Jaṣṣāṣ (d.370/980):

> The *riba* which the Arabs knew and practised meant lending money [dirhams and dinars] with a specified maturity at an agreed upon increase over and above the sum borrowed.[67]

As Jaṣṣāṣ' assertion is not supported by historical evidence or reports and is, furthermore, not in line with earlier reports quoted by Ṭabari, his interpretation may be regarded as unreliable. The view of the current study regarding the fundamental nature of pre-Islamic *riba*, therefore, remains valid.

The last *riba*-related verses were revealed towards the end of the Prophet's mission. Reports available in Ṭabari's commentary on the Qur'ān suggest a date of 8 AH (AD 630) or later. There is general agreement among ex-

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[65] Ṭabari, *Jāmi'*, IV, p.59.
[66] Ibn al-'Arabi, *Aḥkām al-Qur'ān*, I, p.241.
[67] Jaṣṣās, *Aḥkām al-Qur'ān*, I, p.465.

egetes that the verses 2:275-8 were the last verses revealed in relation to the prohibition of *riba*.[68] The verses read:

> Those who devour *riba* shall not rise except as he arises, whom Satan has confounded by his touch. That is because they said, 'Buying and selling is like *riba*.' And yet God has made buying and selling lawful, and *riba* unlawful. Hence, whosoever receives this admonition from his Lord, and then gives up [taking *riba*], may keep his previous gains, and it will be for God to judge him. Whoever reverts to it, they are the people of the Fire, and there they shall abide. God deprives *riba* of all blessing, whereas He blesses charity (*ṣadaqāt*) with growth. And God loves none who is ungrateful and persists in sin. Truly those who believe and do righteous deeds and establish prayer and pay *zakāt* will find that their reward is with their Lord, and that they have no reason to entertain fear or grief. Believers! Hold God in fear and give up all outstanding *riba* if you truly believe. But if you do not do so, then be warned of war from God and His Messenger. If you repent, you are entitled to your principal; neither will you do wrong nor will you be wronged. But if the debtor is in straitened circumstances, let him have respite until the time of ease.[69]

The term *riba* as used in these verses does not differ from its earlier usages in the Qur'ān, according to early exegetes such as Ṭabari,[70] Zamakhshari (d.538/1144),[71] and Ibn Kathīr (d.744/1373).[72] Ṭabari, for instance, interpreted *riba* in these verses, with reference to what was practised in the pre-Islamic period, saying:

> God has forbidden *riba* which is the amount that was increased for the capital owner because of his extension of maturity for his debtor, and deferment of repayment of the debt.[73]

Muḥammad Rashīd Riḍa (d.1935),[74] the well-known disciple of Muḥammad 'Abduh (d.1905), commenting on the meaning of *riba* in this verse, says:

> The particle *'al'* in the term *riba* [in this verse] indicates knowledge and familiarity, which means, 'Do not consume *riba* which was familiar to you and that you used to practise in the pre-Islamic period.[75]

The context of these verses also affirms the moral emphasis the Qur'ān places on the prohibition of *riba*. Fourteen verses preceding the final *riba*-related verses[76] exhorted spending (*infāq*), using the root of the term *infāq* in all fourteen. This spending is for the sake of God[77] to relieve the suffering

[68] Ibn Kathīr, *Tafsīr*, I, p.335.
[69] Qur'ān 2:275-80.
[70] Ṭabari, *Jāmi'*, III, pp.67ff.
[71] Zamakhshari, *Kashshāf*, pp.179-80.
[72] Ibn Kathīr, *Tafsīr*, I, pp.334-6.
[73] Ṭabari, *Jāmi'*, III, p.69.
[74] Riḍa, *Manār*, III, p.94.
[75] Ibid., p.94.
[76] Qur'ān 2:275-80.
[77] Qur'ān 2:261, 262, 272.

of the needy and poor. The recipient's feelings should not be hurt by reminding him of favours done to him:

> Do not deprive your *ṣadaqa* by stressing your own benevolence and hurting [the feelings of the needy], as does he who spends his wealth only to be seen and praised by men, and believes not in God and the Last Day.[78]

These verses indicate unambiguously that the recipients of this spending which the Qur'ān calls *ṣadaqa* are the poor and the needy:[79]

> If you openly give the *ṣadaqa* [to the poor] it is good, but if you conceal it and give it to the poor it is better for you.[80]

Again a little further on, the Qur'ān says:

> And give to the needy who, being wholly wrapped up in God's cause, are unable to go about the earth in search of livelihood. He who is unaware of their condition might think that they are wealthy, because they abstain from begging; but you can recognise them by their special mark: they do not beg of men with importunity. And whatever good you may spend on them, verily God knows it all.[81]

After these exhortations to provide money to relieve the suffering of the poor, and having declared the manifold reward for this spending, the Qur'ān goes on to condemn those who consume *riba* and justify it by saying, "*Riba* is like trade." The Qur'ān rejects this justification, and explains the permissibility of trade and the unlawfulness of *riba*.[82]

The verse combining the statements that trade is lawful and that *riba* unlawful has led some scholars like Mawdūdi (d.1979), the Pakistani scholar and founder of the influential *Jamā'at Islāmi* (Islamic Party), to state that the Qur'ān is contrasting *riba* with the profit resulting from a sale transaction.[83] On this basis, Mawdūdi went on to support the view that the Qur'ān prohibits any form of interest. It must be noted, however, that there does not appear to be a contrast of *riba* with profit. The contrast appears to be between *riba* and *ṣadaqa*. Two points support this view. Firstly, the Qur'ān does not go on to exhort trade (*bay'*), but merely states its lawfulness. Secondly, immediately after this, verse 2:276 contrasts *riba* and *ṣadaqa*, as the Qur'ān previously does in verse 30:39, where the term *zakāt* appears to be synonymous with *ṣadaqa*. Confirmation of the existence of this relationship between *ṣadaqa* and *riba* is provided by the well-known exegete, Rāzi

[78] Qur'ān 2:262-4.
[79] Qur'ān 2:263, 271.
[80] Qur'ān 2:271.
[81] Qur'ān 2:273.
[82] Qur'ān 2:275.
[83] Mawdūdi, *Riba*, pp.82-5.

(d.606/1209).[84] Furthermore, Fazlur Rahman, an influential and Modernist Pakistani scholar, states:

> According to the Qur'ān, the opposite of *riba* is not *bay'* (trade) but *ṣadaqa* (charity). The prevailing confusion about the problem, we submit, was due to *riba* and *bay'* being considered opposed to each other. The result was that juristic hair-splitting was substituted for the moral importance attaching to the prohibition of *riba*.[85]

Having contrasted *riba* with *ṣadaqa,* the Qur'ān commands Muslims to waive the remaining *riba*-charges and to receive only the principal advanced to the borrowers.[86] Failure to do so will lead to "war from God and the Prophet."[87] Finally, the Qur'ān exhorts Muslims to give time to the debtor who is finding it difficult to repay on time.[88]

For several early exegetical authorities, the term 'debtor in difficulty' *(dhū 'usratin)* is primarily a reference to debtors who are poor and unable to pay their debts. Ḍaḥḥāk (d.105/724)) says:

> The expression, 'If you give [the principal] as charity it is better for you', refers to the debtor who is in serious difficulty and, therefore, unable to pay the debt.[89]

According to the Qur'ānic scholar, Suddi (d.127/745), "the principal as charity *(ṣadaqa)* should be given to the poor."[90] While some early scholars suggested that the principal could be given as charity to both the rich and poor, Ṭabari seems to be of the view that it is the poor who should receive this charity. His preferred interpretation of the verse is:

> It is better for you to give even the principal as charity to the poor debtor who is unable to pay the debt.[91]

Two very important statements in the final *riba*-related verses might shed some light on the nature of the *riba* as prohibited in the Qur'ān. The first statement is "*lakum ru'ūsu amwālikum*" (You are entitled to your principal) which is immediately followed by the second "*lā taẓlimūna wa-lā tuẓlamūn*" (Do not commit injustice and no injustice will be committed against you).[92] The first statement declares that it is only the principal which the creditor is entitled to and is, however, only one side of the coin, the other being the second expression, *lā taẓlimūna wa-lā tuẓlamūn.* The two appear to be interdependent and, therefore, one should not single out one without

[84] Rāzi, *Tafsir,* VII, p.90.
[85] Rahman, "Riba and Interest", p.31.
[86] Qur'ān 2:278.
[87] Qur'ān 2:279.
[88] Mawdūdi, *Towards Understanding the Qur'ān,* I, p.221.
[89] Ṭabari, *Jāmi',* III, p.75.
[90] Ibid.
[91] Ibid.
[92] Qur'ān 2:279.

taking the other into account. If the two statements are taken separately and one of them ignored, there is a danger that the meaning which the Qur'ān intends to convey could be distorted.

Did the exegetical literature *(tafsīr)* attempt to explain the meaning of *riba* by laying stress equally on these two statements? Unfortunately, the exegetical works emphasised only the first one, *"lakum ru'ūsu amwālikum"*, and almost completely ignored the second, *"lā taẓlimūna wa-lā tuẓlamūn."* The neglect of the second saying may reflect the methodology followed in almost all schools of Islamic law by which the constituent elements of each command or prohibition in the Qur'ān were interpreted by examining the most immediate and literal meaning of the relevant text, and emphasising it at the expense of the underlying reason or rationale.

Once a prohibition or a command was recognised, its surface meaning was emphasised. The methodology followed in schools of law demanded that commands or prohibitions be followed irrespective of whether or not we know the rationale. In fact, attempts to arrive at a rationale were not even seen to be a fruitful exercise, though some scholars attempted to do so. Since almost all exegetes belonged to schools of law, and rationales were generally ignored in these schools, the exegetes did not seem to find it an attractive option to interpret the meaning of *riba* in the light of its rationale, particularly a rationale based on the second statement, *"lā taẓlimūna wa-lā tuẓlamūn"*. The attitude of the exegetes towards the statement, *"lā taẓlimūna wa-lā tuẓlamūn"*, is indicated by Rāzī's view on the rationale of the prohibition of *riba*. He says:

> The prohibition of *riba* is proved by a text [of the Qur'ān]. It is not necessary for mankind to know the rationale of duties. Therefore, the prohibition of *riba* must be regarded as definitely known even though we do not know the rationale for its prohibition.[93]

The point emphasised by Rāzi is that searching for the rationale of the prohibition is not important; mankind merely has to comply. Furthermore, according to this view, we do not even need to know if any rationale exists. It could be argued that if there is general agreement among Muslims on the meaning, nature and form of what is prohibited, there may not be much point in probing into the rationale. However, in the absence of agreement, it may be difficult to justify such an attitude towards the rationale and we should perhaps be allowing it to have a decisive role in determining what is prohibited. Which transactions are regarded as *riba* and which are not has been a matter of some dispute since the time of the Companions of the Prophet. For this reason, it is of the utmost importance to refer to the rationale in order to arrive at a balanced view as to what is or is not *riba.*

[93] Rāzi, *Tafsir,* VII, p.94.

It cannot be ignored that not much importance was attached to the rationale for the prohibition of *riba* either in the exegetical sources or in juristic discussions, in line with the prevailing juristic emphasis on legal forms, literal and immediate meaning of the relevant texts, and the more concrete aspects of each prohibition. Accordingly, the statement, "You are entitled to your principal", was given prominence, at the expense of the saying, "Do not commit injustice and no injustice will be committed against you." Our contention is that because the rationale "Do not commit injustice and no injustice will be committed against you" is used immediately after the phrase, "You are entitled to your principal", the two phrases and their meanings and import are interrelated and no separation should logically take place, particularly when the preceding verses unmistakably indicate that the Qur'ān was concerned primarily with the plight of the disadvantaged. This is consistent with the invariable Qur'ānic insistence on giving to relieve the suffering of the poor, the needy, one's relatives, and other weak groups in the community. There is no indication that the increases were imposed on rich debtors who borrowed relatively large sums of money to conduct their businesses or for such similar purposes. Emphasising this point, Rāzi says that the lender mostly would be rich, and the borrower destitute or poor.[94] As Riḍa (d.1935) puts it, "*riba* is prohibited because it is an injustice."[95] He also says: "*Riba,* which was an exploitation of the need of their [that is, the Meccans' and Medinans'] brothers, was prohibited."[96] The Ḥanbali scholar Ibn Qayyim (d.751/1356) says:

> In the pre-Islamic period, *riba* was practised by giving extra time to repay a debt and adding a charge against this extension [thus, increasing the amount of the debt] until one hundred became thousands. In most of the cases, only a needy individual would keep doing so as he would have no choice but to defer the payment of the debt. The creditor agreed to defer his demand for repayment of the debt, and waited so that he might gain more profit on the principal. On the other hand, the debtor was forced to pay the increased amount to ward off the pressing demands of the creditor and the risk of the hardships of prison. Thus, as time passed and the loss of the debtor went on increasing, his troubles multiplied and his debt accumulated until all his possessions and belongings were lost to the creditor.[97]

The institution of pre-Islamic *riba* had a propensity to lead the debtor into more debt. The more calamitous his situation, the more he plunged into debt. Hence the well-nigh impossibility of repaying the debt, with the possible consequences being slavery or bonded labour.

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[94] Ibid.
[95] Riḍa, *Manār*, III, p.103.
[96] Ibid., p.108.
[97] Ibn Qayyim, *A'lām al-Muwaqqi'in*, II, p.154.

In pre-Islamic Arab society, there was practically no protection for debtors. There was no legislation to prevent a creditor from forcing the debtor into bonded labour for example. Unlike today, debtors tended not to have a stable income to rely on in repaying their debts. Stable incomes associated with full or part time employment were little known at that time in Mecca and Medina. Uncertainty of income at a certain point in the future was the norm. In such an unpredictable economic and financial situation, entering into a loan agreement, however small the amount may be, would be an immense risk for any poverty-stricken person. What if there is no income to support this debt? What if he could not pay on time? What would happen if he died? It was perhaps the Prophet's recognition of this fact which induced him to discourage Muslims from borrowing. In many of his sayings and even in several of his prayers he reminded Muslims of the undesirability of borrowing unless absolutely necessary.

Today, however, debt is not necessarily associated with poverty. This is particularly true of large scale borrowing for the production of goods and services. Borrowing also takes place for the purchase of consumer products. The borrowers of today, generally speaking, unlike the borrowers of the pre-Islamic period, depend on predictable future incomes to repay their debts, either on the basis of employment or likely future income from business or other sources. Moreover, there are laws to protect borrowers, particularly small scale borrowers, in case they cannot repay their debts on time. The debtor may not be enslaved or forced into bonded labour. The most he could be deprived of would be his personal assets even where these do not cover the debt. Continuing the debt from parents to children does not occur today. The debtor has another opportunity to build a new life, free from debt obligations, after declaring himself bankrupt, an institution that exists also in Islamic law. The vast difference between a modern debtor and a pre-Islamic debtor should not be ignored if we are to have a meaningful discussion on the issue of *riba.*

The Qur'ān addressed itself to a society which lived in a subsistence economy, where meeting even day-to-day basic needs was a major problem. Employment and income were uncertain. For most people, a constant and unrelenting daily struggle for survival was the norm. There was no legal system to protect debtors from exploitation by the powerful and affluent money-lenders. The debtor was at a disadvantage on two fronts, poverty and the debilitating effect of the seemingly unrepayable debt. The Prophet's association of poverty with debt and his constant prayers seeking refuge from both perhaps illustrate the point better than anything else.

The preceding discussion of pre-Islamic *riba* and the context of the *riba*-related verses indicate that *riba* was prohibited primarily to protect the economically and socially disadvantaged in the community. The Qur'ān clearly relates the prohibition of *riba* to the concept of 'voluntary spending'

(*ṣadaqa*) arguing that the economically vulnerable should be protected and assisted, rather than exploited. It is apparently in this context that the Qur'ān commanded Muslims not to impose any charge on debtors if they were unable to pay their debts on time, and to accept only the principal. The Qur'ān goes on to say that foregoing even the principal would be preferable, and that forcing further debt on an already burdened poor debtor is unethical, immoral and against its humanitarian objectives.

Riba and the sunna

The Qur'ān uses the term *riba* in the context of debts. It does not, however, make any reference to the source of the debts, which could be either a loan or a deferred payment sale.[98] On the other hand, the *sunna* mainly uses the term *riba* in relation to certain types of sales practised in the pre-Islamic period.

Very few *ḥadīth* referring to pre-Islamic *riba* (*riba al-jāhiliyya*) are attributed to the Prophet Muḥammad. In his sermon during the Farewell Pilgrimage,[99] he reportedly said: "All [contracts of] *riba* of the pre-Islamic period are null and void. The first [contract of] *riba* I am cancelling is that of 'Abbās b. 'Abd al-Muṭṭalib." Usāma b. Zayd (d.65/685) was quoted as saying: "*Riba* is only in deferment (*nasī'a*)."[100] This is apparently a reference to pre-Islamic custom. In the treaty of the Prophet with the Christians of the town of Najrān in Arabia, the Prophet cancelled the *riba* accrued to their debts which had originated in the pre-Islamic period.[101] None of these *ḥadīth*, however, explains the nature of pre-Islamic *riba* except to some extent the first one, some versions of which add the Qur'ānic phrase "*wa-'in tubtum fa-lakum ru'ūsu amwālikum lā taẓlimūna wa-lā tuẓlamūn*" (If you repent you are entitled to receive your principal. Do not commit injustice, and no injustice will be committed against you), which has been discussed above. This near absence of guidance in the *ḥadīth* literature on pre-Islamic *riba* appears to have prompted the reported saying of 'Umar b. al-Khaṭṭāb (d.23/644) that the Prophet passed away without explaining the meaning of *riba* in the Qur'ān.[102]

A relevant point is that none of the authentic *ḥadīth* attributed to the Prophet in relation to *riba* appears to mention the terms, 'loan' (*qarḍ*) or 'debt' (*dayn*). This absence of any reference to loans or debts in *riba*-related *ḥadīth* led a minority of jurists to contend that what is actually prohibited as *riba* is certain forms of sales, which are referred to in the *ḥadīth* literature.[103]

[98] Ṭabari, *Jāmi'*, III, pp.67ff.
[99] The pilgrimage of the Prophet to Mecca.
[100] Muslim, *Ṣaḥīḥ*, V, p.50.
[101] Ibn Manẓūr, *Lisān*, XIV, p.305.
[102] Ibn Kathīr, *Tafsīr*, I, p.335.
[103] Riḍa, *Riba*, p.11.

These jurists contended that loans or debts should be excluded from the definition of *riba* as, in their view, the Qur'ānic verses relating thereto are explained by the Prophet as occurring in certain sales transactions, not in loans or debts. This view, however, is rejected by the majority of jurists. The prevalent view among the Qur'ānic exegetes and *ḥadīth* scholars is that while the *riba* as prohibited in the Qur'ān is a charge imposed on the debtor against deferment of an already existing debt, the prohibition in the *sunna* is related to certain forms of sales. For example, Riḍa said:

> The prohibition of the sale of the two forms of money [gold and silver] and basic foodstuffs, unless on the basis of immediate delivery of the countervalues for instance, is neither an explanation of *riba*, which is prohibited in the Qur'ān, nor a restriction of *riba* to sales.[104]

Riba in the sunna is related to sales. Most of the *ḥadīth* which have any reference to *riba* are related to certain forms of sale. They contain many instances of the root *b-y-'* (selling). Terms like "*lā tabī'ū*" (do not sell)[105] and "*nahā rasūlullāhi 'an an nabī'a*" (the Messenger of God forbade us from selling)[106] are often used. One such *ḥadīth* which came to be quite prominent in the discussion of *riba* is what we may refer to as the 'six commodities *ḥadīth*'. In the literature, there are many versions of the 'six commodities *ḥadīth*'. The best known version runs as follows:

> The Prophet said: Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt should be exchanged like for like, equal for equal and hand-to-hand [on the spot]. If the types of the exchanged commodities are different, then sell them as you wish, if they are exchanged on the basis of a hand-to-hand transaction.[107]

According to this *ḥadīth*, Muslims may sell these six commodities only if they follow its guidelines. However, confusion arises from the wording of various versions of the *ḥadīth*. Most versions use the expression "*mithlan bi mithlin*" (like for like), "*sawā'an bi sawā'in*" (equal for equal), "*'aynan bi 'aynin*" (same for same), all of which could be taken to mean either equal in quality, quantity or size, or in all of these aspects. There is nothing to suggest that one aspect should be preferred over another. The Ḥanafi jurist Abu Yūsuf's (d.182/798) version[108] of the Companion Abu Sa'īd al-Khudri's *ḥadīth* uses the expressions "*waznan bi waznin*"(weight for weight) and "*kaylan bi kaylin*" (measure for measure), which are unlikely to have been in the *ḥadīth* originally, as none of the other versions uses these expressions

[104] Ibid., p.59.
[105] Rabī' b. Ḥabīb, *Jāmi'*, II, pp.58-9; Mālik b. Anas, *Muwaṭṭa'*, p.289; Muslim, *Ṣaḥīḥ*, V, p.42.
[106] Ibn Abi Shayba, *al-Kitāb al-Muṣannaf*, II, pp.100-1; Dār Quṭni, *Sunan*, Part III, p.18; Dārimi, *Sunan*, II, Part II, pp.258-9; Nasā'i, *Sunan*, VII, pp.275-6.
[107] Muslim, *Ṣaḥīḥ*, V, p.44.
[108] Abu Yūsuf, *Āthār*, p.183.

at all. The way in which the details are given in Abu Yūsuf's version is not characteristic of other versions of this *ḥadīth*, as they do not specify such details. Nevertheless, jurists have generally focused on a particular aspect of equality, for example weight or measure to the exclusion of others.

As interpreted in the schools of law, the 'six commodities *ḥadīth*' means that in any sale transaction involving similar commodities mentioned in the *ḥadīth* (wheat for wheat, for instance), the commodities must be exchanged like for like, and also on an on-the-spot basis, that is, the countervalues must be exchanged immediately. Jurists, however, generally do not discuss why one person would want to sell a measure of wheat for an equal measure of wheat, particularly on an on-the-spot basis. It seems that the intended meaning of the *ḥadīth* was not very clear even to many jurists. For instance, some jurists thought that the prohibition of *riba* in what came to be known as '*riba al-faḍl*' (*riba* involving an excess in one of the countervalues mentioned in the *ḥadīth*) was to be observed and complied with (as in the case of various forms of worship) without probing into the reasons for the prohibition. For these jurists, as reported by Riḍa, the purpose of the prohibition of *riba al-faḍl* was not comprehensible but still had to be complied with.[109]

This confusion among jurists appears to have been due to their total disregard for the rationale (*ḥikma*) of the prohibition of *riba*. It seems that at the time of the Prophet, some forms of sale were common in Medina and the surrounding region, in which one party sold, say, one kilo of wheat for two kilos to be received at the time of the transaction or in the future, or more wheat of inferior quality for less wheat of good quality to be received at the time of the transaction or in the future. Since most people who resorted to such transactions would be less affluent and would only do so because of necessity, there may have been injustice towards or perhaps some exploitation of the weaker party in such dealings. The economically weaker party to the transaction could have been forced to give a higher countervalue, either in terms of quantity or quality, either at the time of the transaction or in the future. In any case, it was the weaker party who suffered most from being forced to pay a higher value than he had received. Moreover, the commodities mentioned in the *ḥadīth* were essential for survival in Medina and surrounding areas. Gold and silver were the two forms of money used. Wheat, barley, dates and salt were basic foodstuffs on which the community depended. The Prophet would not have tolerated the exploitation of the poor in the sale of these essential items. It seems also that in line with his prohibition of certain other forms of sale, the Prophet was most probably attempting to block the potential injustice in the barter exchange of these six commodities. He could have achieved this by completely banning the exchange of such things on a barter basis, and encouraging people to use money to buy goods instead, reasoning that money was a better measure of their value. Leaving the value to the estimation of the two parties on the basis of comparison of two commodities may not result in an acceptable value for the items. The following *ḥadīth* perhaps illustrates the point:

> It is reported that the Companion Bilāl (d.20/641) brought *barnī*[110] dates for the Prophet. The Prophet said: "From where is this?" Bilāl said: "We had inferior quality dates so I exchanged two measures of them for one measure." The Prophet said: "This is exactly *riba*. This is exactly *riba*. Do not do this. If you wish to buy good quality dates sell the dates for something else [in some versions, dirhams] and then buy dates for that."[111]

The same argument, potential injustice, appears to be the most plausible explanation for the prohibition of the deferment of one countervalue in a barter transaction involving any of the six commodities mentioned in the *ḥadīth*. For example, a person in need may prefer to obtain a certain quantity of dates immediately in exchange for a larger quantity later, the increase being in recognition of the deferment. The buyer may not have the ability to repay on time, and the seller may charge more to extend the time of repayment. This is, indeed, the type of *riba* prohibited in the Qur'ān, where the debtor plunges into debt and then is unable to escape. The Ḥanbali scholar Ibn Qayyim is explicit on this point. He said:

> Had the sale of these commodities [wheat, barley, dates and salt] been allowed on a deferred payment basis [in a barter exchange of the same type of countervalues], no one would have sold them unless at a profit. If so, the seller would then have desired to sell them on an on-the-spot basis for the greed of profit. This would have raised the cost of food for the needy, hurting them severely. Most people do not have dirhams or dinars, particularly those living in isolated areas or deserts. Hence, they exchange food for food...Had it been allowed, it could have led to the form of pre-Islamic *riba* which is represented in their saying: "Either you pay or add to the debt". One measure could become ultimately many measures.[112]

The reason for the prohibition of these forms of *riba* (involving sales transactions) appears to be potential injustice to the economically weaker party in a barter transaction. This is further reinforced by several other prohibitions of certain forms of sale common in Medina and Mecca and surrounding areas at the time of the Prophet. Examples of such transactions are: the sale of fresh dates on the trees for dried dates by measure; the sale of dried grapes for fresh grapes; the sale of fruit before it is ripe; the sale of wheat still in ear for ripe wheat; sales in which the deal is completed if the buyer touches

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[109] Riḍa, *Riba*, p.77.

[110] This is a type of good quality date.

[111] Muslim, *Ṣaḥīḥ*, III, p.48.

[112] Ibn Qayyim, *A'lam al-Muwaqqi'in*, II, pp.157-8.

a thing without examining the goods; the sale of grain or vegetables before they are ripe; manipulation and collusion;[113] cheating an unsophisticated entrant into the market; monopsonistic or monopolistic collusion or exploitation to lower or raise prices beyond what is justified by market conditions;[114] and sales involving uncertainty and speculation.[115]

Riba and fiqh

The 'six commodities *ḥadīth*' and other similar *ḥadīth* became the basis of the doctrine of *riba* discussed in Islamic law. Juristic discussion tended, firstly, to probe into the *'illa* (efficient cause) of the prohibition of each commodity mentioned in the 'six commodities *ḥadīth*'. Identification of the *'illa* was intended to extend the prohibition to other similar commodities by means of the jurisprudential tool of 'analogy' *(qiyās),* which meant not to look into the social and moral reasons for the prohibition, but to establish the letter of the law. Since the *ḥadīth* did not provide any reasons for the prohibition concerning these six commodities, jurists had to resort to *ijtihād* to identify the *'illa.* On the basis of certain terms used in some versions of the *ḥadīth*, they arrived at '*illa*s which naturally differed amongst the schools of law. The *'illa* of gold and silver, according to the Ḥanafis, is that the commodities are 'weighable' or 'measurable', while for Mālikis, Shāfi'is and Ḥanbalis, the *'illa* is that they are 'currency'. As for wheat, barley, dates and salt, the *'illa* is that they are 'weighable' or 'measurable' *and* that they belong to the same genus (Ḥanafis); are storable nourishment for mankind (Mālikis); are foodstuffs (Shāfi'is); or are foodstuffs which are measurable or weighable (Ḥanbalis).[116]

Based on the *'illa,* there could be a host of commodities susceptible to *riba.* Differences among the scholars of law on the nature of the *'illa* often led to irreconcilable consequences. Eggs, for instance, could be exchanged one for two, according to the Ḥanafis, as they are not weighable or measurable, but would not be allowed according to the Shāfi'is, as they are foodstuffs. Mālikis, like the Shāfi'is, would allow such a transaction because an egg is not a foodstuff which is storable for a reasonable length of time, like wheat. Not all schools of law, however, attempt to extend the prohibition. The Ẓāhiri school of law rejected the extension, and restricted the prohibition to the six commodities mentioned in the *ḥadīth.*[117] Other schools, especially the four surviving Sunni schools of law, extended the prohibition to other commodities.

[113] Bukhāri, *Ṣaḥiḥ,* III, pp.177-241.
[114] Chapra, *Towards a Just Monetary System,* p.66.
[115] Jazīri, *Fiqh,* II, pp.183-91, 273-8.
[116] Ibid., pp.249-52.
[117] Saleh, *Unlawful Gain,* p.15.

The jurists divided *riba* into *riba al-nasī'a* and *riba al-faḍl*, that is, *riba* involving respectively a deferment of one countervalue, and an excess in one countervalue. The schools of law are not in agreement on the exact definition of these two types of *riba.* An outline of the generally accepted views of the major four Sunni schools, Ḥanafi, Māliki, Shāfi'i and Ḥanbali, would serve to illustrate the point:

Riba al-faḍl occurs, when, in an on-the-spot (hand-to-hand) transaction, there is an excess in one of the countervalues which belong to the same genus (*jins*) and both countervalues are (i) weighable or measurable (Ḥanafis); (ii) either currency, or storable nourishment for mankind (Mālikis); (iii) either currency, or foodstuffs (Shāfi'is); and (iv) either currency or are measurable or weighable (Ḥanbalis).[118]

Riba al-nasī'a occurs when delivery of one countervalue is deferred in a sale transaction involving countervalues which are susceptible to *riba.* The countervalues should be: (i) of the same genus or both weighable or measurable (Ḥanafis); (ii) storable nourishment for mankind, or both currency (Mālikis); (iii) both foodstuffs, or both currency (Shāfi'is); or (iv) both measurable, or weighable, or currency (Ḥanbalis).[119]

The general rules the jurists derived in relation to *riba* in sales can be summarised as follows. In a sale transaction:

- if the countervalues are gold, silver, barley, wheat, dates or salt, or any other commodity which is likely to involve *riba* by analogy *(qiyās)*, the countervalues should be exchanged on the spot, and they should be equal. Deferment of or increase in one countervalue would be *riba*;
- if the countervalues differ in their genus (for instance, exchanging gold for silver, or, wheat for barley), the countervalues should be exchanged on the spot, but their equality is not essential. When one of the countervalues is currency, the two do not have to be equal, and one countervalue could be deferred.[120]

Lack of emphasis on the moral aspect of the prohibition in the juristic discussion of riba. The jurists extended the prohibition of *riba* found in the Qur'ān and *sunna* to various transactions by means of analogy *(qiyās)* on the basis of the 'efficient cause' *('illa)*, not on the basis of the underlying reason or the rationale *(ḥikma).* As it is relevant to this study, a brief outline follows of the argument in the principles of jurisprudence *(uṣūl)* on whether or not the *ḥikma* can perform the function of *'illa* in *qiyās.*

Several conditions are mentioned in the *uṣūl* for the use of *'illa* to extend a rule in Islamic law to a new issue by means of *qiyās.* Among them are that the *'illa* should be clear and explicit, and that its existence should have

[118] Saleh, *Unlawful Gain,* pp.19-26; Jazīri, *Fiqh,* II, pp.250ff.
[119] Saleh, *Unlawful Gain,* pp.19-26.
[120] Ibid.; Jazīri, *Fiqh,* II, pp.247ff.

been ascertained independently.[121] As for extending a rule on the basis of *ḥikma,* there are three contrasting views: (i) *ḥikma* can perform the function of *'illa* whether it is explicit or not or whether its existence can be ascertained independently or not. This view is attributed to Fakhr al-Dīn al-Rāzi and Bayḍāwi (d.685/1286); (ii) *ḥikma* cannot perform the function of *'illa* at all. This view is attributed to the majority of scholars of *uṣūl al-fiqh;*[122] and (iii) if the *ḥikma* is explicit and if its existence can be ascertained independently, then it can perform the function of *'illa.* This is the view of Āmidi (d.551/1156).[123]

Scholars who are of the opinion that *ḥikma* can perform the function of *'illa,* argue that *ḥikma* is the intention of the lawgiver in enacting the law. If it cannot be used to extend the rules, then the *'illa* which is after all based on the *ḥikma* cannot be used for extension of a rule. If *'illa* can be used, then *ḥikma* should be given priority in extending the rules.

This argument is important for any discussion of the extension of the prohibition of *riba* to other transactions. The Qur'ānic prohibition for instance, appears to have been extended to all loans and debts where an increase accrues to the creditor, mainly on the basis of the statement in the verse "*lakum ru'ūsu amwālikum*". In other words, the "increase in a loan/debt accruing to the creditor over and above the principal" was regarded as *'illa,* whereas the second expression in the same verse, "*lā taẓlimūna wa-lā tuẓlamūn*"(which is the *ḥikma*) is relegated to a secondary position, or more accurately, was ignored altogether in the discussion of *riba.* The extension of rules related to the prohibition of *riba* in the *sunna* was also made on the basis of *'illa,* not *ḥikma.*

The reason why the scholars have regarded *ḥikma* as minor and unimportant appears to be that the *'illa* could be used objectively and easily, whereas the jurist would have to consider many factors in arriving at a decision on the basis of *ḥikma.* A decision arrived at in that way would change according to the circumstances, whereas a decision arrived at on the basis of *'illa* could remain 'immutable'.

An example relating to *riba* will clarify the point. Based on the *'illa* 'an increase in a loan/debt accruing to the creditor over and above the principal', any transaction which involves such an increase would be prohibited as *riba.* If, on the other hand, prominence is given to the *ḥikma* 'the existence of injustice in a particular transaction related to loan/debt', then not every transaction involving an increase would be prohibited as *riba,* but only those involving an injustice to one of the contracting parties. It must also be noted that whereas the *'illa* approach allows loan transactions that are *riba* to be identified more easily, the *ḥikma* approach, in contrast, demands that the jurist look at the circumstances of each transaction in order to identify what is or is not *riba.* Although the *'illa* is easier to use, in many cases it may not serve the intended purpose of the particular rule stated in the Qur'ān or in the *sunna.* It will be argued, however, that the *ḥikma* can serve such a purpose.

121 'Abd al-Ḥamīd, *Ḥujjiyyat al-Qiyās,* p.112.
122 Āmidi, *Iḥkām,* III, p.290.
123 Ibid.

The inadequacy of the *'illa* approach is glaringly obvious in the discussion of *riba* in both the early and the modern period. In the case of *riba* as prohibited in the *sunna* for instance, each school of law arrived at an *'illa* which had nothing to do with the circumstances of the transaction, the parties thereto, or the importance of the commodity to the survival of society. There was no emphasis on the moral aspect. This approach, which could be described as superficial and devoid of moral and humanitarian considerations, led to some amazing conclusions by several jurists. Coins like *fals,*[124] for instance, did not involve *riba,* according to the Shāfi'is.[125] Thus, one hundred *fals* could be exchanged for two hundred either on the spot or on a deferred delivery basis. If this is maintained, then obviously today's fiat money could also be put in this category, since it is neither gold nor silver currency. Commodities which were countable, like apples or eggs, did not involve *riba,* and hence could be exchanged less for more, according to some jurists.[126] A piece of cloth could be exchanged for two pieces of the same quality and measure since it was neither 'currency' nor 'measurable' nor 'weighable', nor a 'foodstuff'. A commodity to which the *'illa* did not apply could not be susceptible to *riba (māl ribawī)* whatever the importance of that commodity to the well-being of the community. In the context of the Pakistani economy, Fazlur Rahman remarked:

> Therefore, the question of *riba* does not arise with regard to those commodities which are the backbone of Pakistan's economy, ie. jute and cotton! However, it is possible that our *fuqahā'* (legists) may reply that jute is "the golden fibre" and cotton is "the silver crop"! Therefore, they also fall within the category of gold and silver. The same principle will apply to the oil found in Arabia, Persia and elsewhere because oil is called "liquid gold". But what judgement will our legists pass on hides and skins which are an important source of the wealth of our country?[127]

The lack of moral emphasis in the juristic interpretation of *riba* has also led to some other unfortunate developments as in the case of *riba*-related *ḥiyal.*[128] From the medieval period to the present day, it has been possible to advance loans at exorbitant rates of interest using fictitious transactions. Similarly, the six commodities and other goods likely to involve *riba* could

124 A unit of currency made of a metal which is not gold or silver and was used in some parts of the Muslim world.
125 Jazīri, *Fiqh,* II, p.272.
126 Ibid., p.260.
127 Rahman, "Riba and Interest", p.21.
128 '*Ḥiyal* ' is the plural of *ḥīla* which signifies "a means of attaining to some state concealedly". Lane, *Arabic-English Lexicon,* I, part 1, p.676.

be exchanged. Many jurists would not regard such acts as reprehensible since they are perfectly in line with their legalistic thinking. These jurists accord greater importance to the legal form of the transaction than to the moral consequences. As long as the transaction literally does not fall into the definition of *riba*, as provided by each school of law, the transaction would not be regarded as such.

A detailed discussion of the issue of *ḥiyal* is not within the scope of this chapter. It is no secret in Islamic law that such *ḥiyal* were utilised by Muslims with the blessing of many jurists. However, the schools of law are not in agreement on the permissibility of *ḥiyal*, at least the most extreme forms of *ḥiyal* which are used to evade clear prohibitions of the *sharī'a*. The Ḥanafis and the Shāfi'is are the most favourably inclined to accept the legality of *ḥiyal*[129] while the Ḥanbalis and the Traditionists (*ahl al-ḥadīth*) are its most vocal opponents. Below are cited a few examples of *ḥiyal* used in order to circumvent the prohibition of *riba* by means of fictitious transactions. These examples are from Khaṣṣāf's work on *ḥiyal*.

Ḥīla (stratagem) to lend money at any rate of interest: A person, *A*, needs to borrow money from a trader on the basis of *ḥīla* (that is, *mu'āmala*). An individual, *X*, comes and asks Khaṣṣāf about the *ḥīla* for this.

Khaṣṣāf: If *A* who needs to borrow on the basis of *mu'āmala* owns land or a house, *A* can sell it to the trader for the amount *A* requires. If the trader takes possession of it and sells it back to *A* and makes a 'profit' in the sale, on which both parties agree, this is lawful.

X: If *A* does not own land or a house...?

Khaṣṣāf: If *A* owns a slave or any commodity, and the trader buys it from *A*, takes possession of it, and sells it back to *A* (at a 'profit') there is no harm in it.[130]

Utilising this trick, a person can lend at any rate of interest. This is apparently perfectly legal!

Ḥīla to circumvent the prohibition of riba al-nasī'a in money exchange:

X (asking Khaṣṣāf): A person, *A*, intends to buy from a money-dealer dirhams for 100 dinars. If the money-dealer has only 500 dirhams, what is the *ḥīla* for this?

Khaṣṣāf: *A* should buy from the money-dealer the 500 dirhams for the equivalent in dinars, and they exchange dirhams for dinars. Then, *A* lends the money-dealer the 500 dirhams, and immediately after that buys the 500 from him. This process could be repeated until the 100 dinars

[129] Among the Ḥanafi authorities who wrote works on *ḥiyal* are Abu Yūsuf (d.182 AH), Shaybāni (d.189 AH) and Khaṣṣāf (d.261 AH), and among the Shāfi'is, Muḥammad b. 'Abd Allah al-Sayrafi (d.330 AH), Abu al-Ḥasan Muḥammad b. Yaḥya b. Surāqa al-'Āmiri (d.416 AH), and Abu Ḥātim Muḥammad b. Ḥusayn al-Qazwīni (d.440 AH).

[130] Khaṣṣāf, *Ḥiyal*, p.11.

are given to the money-dealer, and the money-dealer owes *A* the equivalent dirhams for the 100 dinars.[131]

In the interpretation of *riba*, deferment of one countervalue in money exchange (*ṣaraf*) is *riba*. The *ḥīla* overcomes this problem.

Ḥīla to lend money at interest with land as security:

X (asking Khaṣṣāf): A person, *A*, requires 10,000 dinars from a trader, *B*, land being security. *B* tells *A* that the land should be in *B*'s possession, and he will make a 'profit' of 5,000 dinars on the transaction (that is, interest on lending). What is the *ḥīla* for that?

Khaṣṣāf: The trader, *B*, should sell something (a garment or anything else) to *A* for 5,000 dinars (to be paid later) and delivers that item to *A*. *B*, then, buys the land from *A* for 10,000 dinars, and gives the dinars to *A*, and writes a document stating the 10,000 dinars, and the previous 5,000 dinars which *A* owes to *B*. *B* promises that when *A* returns the 15,000 dinars, he will return the land.[132]

By utilising these and other similar *ḥiyal* advocated by the jurists, lending at interest, at any rate of interest, can be practised in the form of a fictitious sale or transaction. Proponents of *ḥiyal* claim that this is not lending at interest, but simply buying and selling, usually calling it *mu'āmala shar'iyya* ('a legal transaction')! These and other similar *ḥiyal* are an unpleasant reminder to us that emphasising the legal form and ignoring the moral consequences of the prohibition of *riba* can lead to a *sharī'a* injunction devoid of meaning.

Concluding remarks

The Qur'ān, from the very beginning of the Prophet's mission, was concerned with the lower socio-economic groups. It attempted to protect these strata of society by demanding that they not be exploited by the rich and affluent. In this context, the Qur'ān blamed the institution of *riba* and prohibited it, as it was essentially the imposition of an increase on a needy debtor who was having problems in repaying a debt, thus increasing the misery and the debtor's burden, which was compounded as time passed. Again and again, the Qur'ān insisted that such people should be helped, not exploited. It also demanded that the affluent should give money to provide for the needy and disadvantaged. If such debtors could not repay their debts on time, they should be given an extension without any added burden. The economy of Mecca and Medina at the time of the Prophet was more or less a subsistence economy, and large scale lending and borrowing for non-humanitarian purposes did not seem to be widely practised. Debt in that society appears

[131] Ibid., pp.13-4

[132] Ibid., pp.11-2.

to have been generally a means of meeting a pressing need on the part of the economically disadvantaged.

This is the moral framework within which the Qur'ān dealt with both the issue of debt and the increases imposed on hard-pressed debtors by their creditors. The context of the *riba*-related verses again and again indicated that the Qur'ān was dealing with the issue of *riba* from a moral perspective not a legal one. The *sunna* also dealt with the issue of *riba* from this moral standpoint. However, in Islamic law, in determining what is *riba* and what is not, Muslim jurists focused mainly on whether a particular loan transaction had an element of increase over and above the principal, or whether certain qualities existed in a particular commodity likely to be identified with *riba*. In both cases, the jurists almost totally ignored the nature and circumstances of the transaction, the parties to the transaction, the prevailing economic environment within which it took place, and its purpose. Thus, the issue of *riba* in Islamic law became merely a 'legal' issue concerned with the outward 'form', having no place whatsoever for the moral framework within which the Qur'ān and *sunna* appear to have dealt with the issue. The point to be made here is that unless the moral importance attached to the prohibition of *riba* is emphasised, which is hardly the case in the current debate, there is a danger that the whole discussion may become a meaningless exercise and a quibble over semantics, as is demonstrated by the case of the use of *ḥiyal*.

CHAPTER THREE

INTERPRETATION OF RIBA IN THE MODERN PERIOD

This chapter deals with the issue of *riba* in the modern period. Contemporary Muslim scholars have differed as to whether the *riba* prohibited in the Qur'ān applies to modern bank interest. These differences appear to stem from one basic issue: should the emphasis be on the rationale for the prohibition of *riba*, that is, injustice, or should it be on the legal form in which *riba* came to be formally conceptualised in Islamic law. The Modernist trend is towards the former, while the neo-Revivalists tend towards the latter view. It is important to note that what is referred to here as the neo-Revivalist interpretation is in fact the traditional interpretation with stress on the point that any interest is *riba*.

Modernist views on riba and interest

Modernists like Fazlur Rahman (1964), Muhammad Asad (1984), Sa'īd al-Najjār (1989) and 'Abd al-Mun'im al-Namir (1989) tend to emphasise the moral aspect of the prohibition of *riba*, and relegate the 'legal form' of *riba*, as interpreted in Islamic law to a secondary position. They argue that the *raison d'être* for the prohibition is injustice, as formulated in the Qur'ānic statement, "*lā taẓlimūna wa-lā tuẓlamūn*" (Do not commit injustice and no injustice will be committed against you). Modernists also find some support for their views in the works of early scholars, like Rāzi, Ibn Qayyim and Ibn Taymiyya. Rāzi, a commentator on the Qur'ān, in his enumeration of reasons for the prohibition of *riba*, said: "The fourth reason is that the lender mostly would be rich, and the borrower poor. Allowing the contract of *riba* involves enabling the rich to exact an extra amount from the weak poor."[1] The Ḥanbali scholar, Ibn Qayyim, also linked the prohibition to its moral aspect. Referring to the pre-Islamic *riba*, he says that in most cases the debtor was destitute with no choice but to defer the payment of the debt.[2] It is this reason, according to the Modernists, which makes the prohibition morally sustainable in a changing socio-economic environment. According to the modern commentator on the Qur'ān, Muhammad Asad:

> Roughly speaking, the opprobrium of *riba* (in the sense in which this term is used in the Qur'ān and in many sayings of the Prophet) attaches to

[1] Rāzi, *Tafsīr*, VII, p.94.
[2] Ibn Qayyim, *A'lam al-Muwaqqi'in*, II, pp.157ff.

> profits obtained through interest-bearing loans involving an *exploitation of the economically weak by the strong and resourceful*... With this definition in mind, we realise that the question as to what kinds of financial transactions fall within the category of *riba* is, in the last resort, a moral one, closely connected with the socio-economic motivation underlying the mutual relationship of borrower and lender.[3]

Another modern commentator, Abdullah Yusuf Ali, attempted to define *riba* from this moral perspective. He said:

> There can be no question about the prohibition [of *riba*]... The definition I would accept would be: undue profit made, not in the way of legitimate trade, out of loans of gold and silver, and necessary articles of food such as wheat, barley, dates and salt... My definition would include profiteering of all kinds, but exclude economic credit, the creature of modern banking and finance.[4]

The Pakistani scholar, Fazlur Rahman, remarked on the attitude of many Muslims towards interest:

> Many well-meaning Muslims with very virtuous consciences sincerely believe that the Qur'ān has banned all bank interest for all times, in woeful disregard of what *riba* was historically, why the Qur'ān denounced it as a gross and cruel form of exploitation and banned it, and what the function of bank interest [is] today.[5]

For these scholars, it appears that what is prohibited is the exploitation of the needy, rather than the concept of the interest rate itself. It is the type of lending that attempts to profit from the misery of others. Many writers of this trend attempt to differentiate between various forms of interest practised under the traditional banking system, advocating the lawfulness of some, while rejecting others.[6] The rejection is generally based on a perceived injustice in a particular form of interest. In this chapter, several such views are set out, along with criticisms levelled at them.

What is prohibited is pre-Islamic riba. It has been claimed that according to Muḥammad 'Abduh (d.1905) who was the Grand Mufti of Egypt, and his disciple Muḥammad Rashīd Riḍa, what is prohibited is the form of *riba* practised in the pre-Islamic period. In his summary of 'Abduh and Riḍa's views, Nabil Saleh suggests that according to them, the first increase on a termed loan is lawful but if, at maturity date, it is decided to postpone that maturity date against a further increase, this would be prohibited.[7] This view is apparently based on the reports available in Ṭabari's commentary in relation to how *riba* was practised in the pre-Islamic period (see chapter 2). It must be noted that these scholars were not explicitly and openly suggest-

[3] Asad, *The Message*, p.633.
[4] Ali, *The Holy Qur'ān*, p.111.
[5] Rahman, "Islam: Challenges and Opportunities", p.326.
[6] Saleh, *Unlawful Gain*, p.29.
[7] Ibid., p.28.

ing that interest is acceptable without any qualification. Supporting this, Chibli Mallat made the following point in his discussion on the Egyptian Savings Funds scheme of the early twentieth century:

> Neither Muḥammad 'Abduh nor Rashīd Riḍa were comfortable about the interest yielded to the depositors on their monies, but they seem to have tolerated it if a scheme of *muḍāraba* could be devised to legitimise the interest on the employee's deposits.[8]

Following to some extent the views of 'Abduh and Riḍa as well as those of Ibn Qayyim, 'Abd al-Razzāq Sanhūri, the Egyptian authority on Islamic law, has suggested that it is compound interest which is first and foremost prohibited in verse 3:130. As reports explaining pre-Islamic *riba* testify,[9] and also by implication, simple interest would not be prohibited. Another Egyptian scholar of Islamic law, Ibrahim Zaki al-Badawi, also argued that the strict prohibition of *riba* should apply only to the pre-Islamic form, which according to him is, "the increase in debt principal *at the time of the accrual* in order to receive a new loan"[10]

Against this, critics assert that verse 3:130 is the first stage of the prohibition of *riba*, or that the term *"aḍ'āfan muḍā'afatan"* (doubling and redoubling) mentioned in the verse is only explaining what the Arabs practised, not that the interest charged would be lawful if the amount were not doubled.[11] Moreover, in their view, the last *riba*-related verses (2:275-8) have clearly stated that any increase over and above the principal should be *riba*, and as such prohibited. This applies to any form of interest whether it is simple, compound, fixed or variable.

'Need' as a reason for allowing simple interest. Sanhūri, following Ibn Qayyim, attempted to distinguish between various forms mentioned in the literature: pre-Islamic *riba (riba al-jāhiliyya)*, *riba* of deferment *(riba al-nasī'a)*, *riba* of increase *(riba al-faḍl)* and *riba* of loans *(riba al-qarḍ)*. Sanhūri maintained that the prohibition of *riba* in all its forms should be the norm, although the level of prohibition in them varies. For this reason, *riba* cannot be regarded as lawful except for necessity *(ḍarūra)* or need *(ḥāja)*. According to him, pre-Islamic *riba*, the worst form of *riba* which is 'similar to what we call compound interest today' is prohibited without qualification. Even necessity does not accommodate such a permission in the case of the creditor, Sanhūri argues. While the debtor may be compelled to borrow on the basis of interest at exorbitant rates, where is the compelling necessity of the creditor to charge compound interest? he asks.[12] On the other hand, since *riba* of deferment, *riba* of increase and *riba* of loans are prohibited to

[8] Mallat, "The Debate on Riba", p.74.
[9] Sanhūri, *Maṣādir al-Ḥaqq*, III, pp.241-2.
[10] Quoted in Mallat, "The Debate on Riba", p.80.
[11] Drāz, *Riba*, pp.12-3.
[12] Sanhūri, *Maṣādir al-Ḥaqq*, III, pp.241-2.

prevent the occurrence of pre-Islamic *riba,* they may be permitted temporarily, in case of 'need' and according to the severity of the 'need', says Sanhūri.[13] In the case of interest on loans, he comments:

> In a capitalist economic system, capital is owned by individuals, institutions and banks; it is not owned by the government. There is a general need for the entrepreneur to obtain capital for investment.... As long as there is a need for obtaining capital by means of a loan, and the capital is not owned by the government, interest on capital within the stated limits would be lawful, as an exception from the original prohibition. The individual owns capital, which he saved by his labour and effort; he has an obligation not to do injustice and a right not to have any injustice done unto him.[14]

Having regarded simple interest on capital as lawful in the case of 'need', Sanhūri is quick to state that the law should specify limits to the interest rate, the method of payment, and the total interest to be paid so as to estimate what is required for each particular case.[15]

Critics do not see that even 'need' can legitimise interest. They do not maintain that there are 'levels of prohibition'. Since all forms of *riba* are prohibited by the Qur'ān and the *sunna* the prohibition is binding.

Consumption loans or production loans. Some Modernists, like the contemporary Syrian politician, Doualibi, differentiate between 'consumption loans' and 'production loans' and argue that interest on production loans is lawful, but interest on consumption loans is unlawful.[16] This is on the basis that Qur'ānic verses relating to *riba*, in their view, occur in the context of alleviating the misery of the poor, the needy, the weaker sections of the community, and those who, having got into debt, are then unable to discharge that debt. They contend, therefore, that the Qur'ānic prohibition is related to consumption loans.[17] They claim confirmation in the reports explaining the nature of pre-Islamic *riba*. Since there is no direct evidence of the existence of loans for 'production' purposes on a wide scale in the pre-Islamic period, credit for investment, according to this view, is a post-Qur'ānic phenomenon, and therefore should be evaluated in terms of the rationale of prohibition, that is, injustice.[18]

Critics, however, argue that, rather than consumption loans, it was mainly loans for investment, that is, for production purposes, which were prevalent in Ḥijāz (in Arabia) at the time of the prohibition of *riba*. To support their view, these critics rely on several reports mentioned in Ṭabari's

[13] Ibid., p.242.
[14] Ibid., pp.243-4.
[15] Ibid., p.244.
[16] Abu Zahra, *Buḥūth fi al-Riba*, pp.52-7; Saleh, *Unlawful Gain*, p.29.
[17] Ibid.
[18] Jafarey, "The Case for Ijtihad in Respect of Interest on Production Loans", pp.15-20.

commentary on the Qur'ān.[19] They argue that these reports indicate that some tribes or clans used to borrow money for trade and investment from other tribes.[20] Doualibi and others could, however, argue that there were several problems in using these reports in support of the existence of loans for production purposes. Firstly, none of the reports in Ṭabari's commentary specifies that the funds or commodities lent were for investment. It is merely an inference on the part of the proponent of the investment loan thesis that the money *must* have been borrowed for productive purposes, just as in the same way, the proponent of the consumption loan thesis assumes that borrowing in that period *must* have been for consumption. Secondly, the reports, of which there are two versions, are contradictory. One version indicates that the alleged transactions were between 'Abbās b. 'Abd al-Muṭṭalib and his partner from the clan of Mughīra, and some people from the tribe of Thaqīf. 'Abbās and his partner were to be the recipients of this *riba*.[21] In Ibn Jurayj (d.150/767) and Muqātil's (d.150/767) version, the clan of 'Amr of Thaqīf tribe were the recipients of *riba* from the clan of Mughīra who refused to pay it. There is no mention of 'Abbās in this version.[22] Another report which attempted to explain the 'occasion of the revelation' (*sabab al-nuzūl*) of verses 2:275-8 asserted that the verses were revealed about 'Abbās b. 'Abd al-Muṭṭalib and 'Uthmān b. 'Affān who had lent some dates.[23] Finally, Ṭabari himself did not assert, as the critics do, the historicity of these reports. He merely stated in the passive form: "*it is said*, that this verse [2:278] was revealed about some people who had *riba*-claims against some other people", without naming these people or even mentioning the purpose for which this *riba*-related debt was concluded in the first place.[24] For these reasons, it appears that the historical validity of these reports to support the thesis that lending and borrowing in the Ḥijāz at the time of the prohibition of *riba* were mainly for investment is, at best, doubtful.

Individuals or institutions. Some scholars argue that the prohibition of *riba* covers only individuals, not the giving or taking of interest amongst corporate bodies, such as companies, banks, or governments. The view is also expressed that receipt of interest by an individual from corporate bodies like banks should not be prohibited because an individual cannot exploit a larger organisation like a bank.[25] The Council of Islamic Ideology in

[19] Qaraḍāwi, "Riba al-Bunūk Aswa' min Riba al-Jāhiliyya", pp.65-6; Ahsan, "An Exposition of the Common Misgivings", p.237.
[20] Abu Zahra, *Buḥūth fi al-Riba*, pp.53-6.
[21] Ṭabari, *Jāmi'*, III, p.71.
[22] Ibid.; Rāzi, *Tafsir*, VII, p.106.
[23] Ibid.
[24] Ṭabari, *Jāmi'*, III, p.70.
[25] Khan, "Divine Banking System", pp.30-2; Qureshi, "Islamisation of Financial Institutions", pp.66-7.

Pakistan, in 1964, was also hesitant to declare institutional credit *riba*:

> The Advisory Council of Islamic Ideology agrees that *'riba'* is forbidden but is in disagreement as to whether 'interest in the form in which it appears in public transactions' which in the opinion of Council includes 'institutional credit' as well, would also be covered by *riba* [as] specified in the Holy Qur'ān.[26]

Critics could dismiss this argument on the grounds that committing a crime either against an individual or an institution is the same under Islamic law, and that all corporate bodies and governments ultimately represent peoples. Furthermore, institutions can be as exploitative as an individual, and the Qur'ān does not make any distinction between an institution and an individual in the matter of *riba*.

Interest or usury. Another view is that Islam has prohibited 'usury' not 'interest'. Based on verse 3:130, the Egyptian scholars Ḥafni Nāṣif and 'Abdul 'Azīz Jāwish in the early part of the twentieth century, asserted that the *riba* which is prohibited, and on which there is consensus of opinion, is interest when it equals the principal or more. According to this view, the claim, that an amount of interest which is less than the principal is not lawful, is debatable.[27] This is the position adopted in the Egyptian civil code which states that it is not permitted under any circumstances for the creditor to receive interest which exceeds the amount of the principal.[28] It is no coincidence that some modern Qur'ānic commentators in English, like Muhammad Asad[29], have used the term 'usury' for *riba*, while in the translation of Mawdūdi's commentary on the Qur'ān (*Tafhīm al-Qur'ān*), the translator Zafar Ishaq Ansari, a Pakistani scholar who is associated with *Jamā'at Islāmi* of Pakistan, used the term 'interest'.[30]

Critics could argue that the terms 'interest' and 'usury' did not denote two different things until the Reformation in Europe.[31] Neither in Judaism nor in Christianity, had the distinction between the two terms been recognised, let alone accommodated, until the Reformation.[32] Hence, critics could argue that the attempt to differentiate between interest and usury in order to allow the former is an alien concept to Islamic law.

Nominal or real interest. It has been suggested that in an inflationary economy, an interest rate which will correct the loss suffered by the creditor due to inflation could be justified by means of the indexation of loans, that is, by allowing an increase to compensate for loss of the purchasing power

[26] This was in response to a question from the Ministry of Finance, Pakistan, and the decision was taken on the 13th of January, 1964. Zaidi, "Islamic Banking in Pakistan", p.21.
[27] Drāz, *Riba*, p.9.
[28] Egyptian Civil Law, Article 9.
[29] Asad, *The Message*, pp.61-2.
[30] Mawdūdi, *Towards Understanding the Qur'ān*, I, pp.213, 214, 217, 220, 286.
[31] Miṣri, *Maṣraf al-Tanmiyat al-Islāmi*, pp.80-1.
[32] Drāz, *Riba*, pp.5-8.

of the money. To bolster their argument, proponents of this view, like contemporary scholar Shawqi Dunya (1985), bring forward some related views of jurists to their discussion of loan contracts.

As discussed in *fiqh* literature, the debt in a loan could be either a commodity or money. If it is a commodity, the jurists generally held the view that the debtor should repay with a similar commodity (a kilo of wheat in payment for a kilo of wheat, for example) in so far as there exists a similar commodity. Otherwise its value would be sufficient, if its value has not changed since the loan contract was concluded. Difference of opinion exists when the value of the commodity changes. If the change was a result of a defect in the commodity, then most of the jurists take the view that the original value of the commodity should be returned. If the change in value was due to a change in place (country or city for example), the majority view is that the value of the object of debt *when the debt occurred* should be paid, and not a similar commodity. If the change was due to a change in time, that is, as a result of a fluctuation in price, some say that a similar commodity should be paid, while others say that the original value of that commodity should be given.[33]

When the debt is money, and its value changes, some jurists take the view that even though its value has changed, the creditor should accept the original sum in repayment of the debt. The Ḥanafi jurists in general, and the famous Ḥanbali scholar Ibn Taymiyya are of the view that the value of the money *when the debt occurred* should be paid.[34] The range of views leads to the conclusion that there is no consensus on the issue of whether, in an inflationary or deflationary situation, equal units of money should be paid in repayment of a loan. A Pakistani scholar, Qureshi, summarised the argument when he said:

> According to Islamic principles of finance, the like should be returned for the like and any excess over the loan amount would be defined as *'riba'*. In [the] case of physical capital or metal or [a] commodity such as gold, the repayment of [the] loan would strictly retain the original form, shape and substance of the borrowed capital. Translated in terms of paper currency and modern financial transactions, the condition of retaining the form, substance and shape may be satisfied by repaying the loan in terms of [the] undiluted purchasing power of the original amount of loan.[35]

Khalid Mohammed Ishaque, a Pakistani scholar, reiterated the same view:

> [The] Qur'ān ordains that savings (wealth) not in use must be available for use by others; and no gain be desired by the owner of this wealth if he is himself not using it. Therefore, so long as it is assured that one who has saved shall get back what he has saved (and not paper currency of [the]

[33] Dunya, "Taqallubāt al-Quwwat al-Shirā'iyya", pp.39-45; Jazīri, *Fiqh*, II, pp.338-45; Ibn Qudāma, *Mughni*, IV, pp.352-3.
[34] Dunya, "Taqallubāt al-Quwwat al-Shirā'iyya", pp.32-52.
[35] Qureshi, "Instruments of Islamic Banking", p.73.

> same denominational value with a constantly eroding purchasing power), he should have no cause for complaint.... If the currency is subject to inflation or deflation, parties would have to provide return at a constant value, ie. value of purchasing power (if it is a currency loan) as on the date of loan.[36]

Critics have dismissed this argument on several grounds, maintaining that any increase would be contrary to the Qur'ānic command to receive only the principal, which, they argue, is stated in monetary terms. According to the Council of Islamic Ideology (CII) Report on the Islamisation of Pakistani banking and financial institutions, "the basic principle is that the same quantity (units) should be returned as was borrowed even though the price of the commodity may have changed in the meantime."[37] More difficult is the question of ascertaining which rate should be applied to compensate for the loss arising due to inflation. Since there are many indices which measure the purchasing power of money, such as the consumer price index and the wholesale price index, all of which suffer from some drawbacks, it would be difficult to arrive at a universal rate which could be used for indexation.[38] Even if one such rate were found, the feasibility of using it in banking would be highly questionable, as this would mean that banks would need to index their deposits as well as their loans to investors. Indexing the former to the exclusion of the latter would not be feasible in banking, and could create havoc on bank balance sheets. According to Chapra, an Islamic banking theorist, "widespread index-linking has not been found to be feasible because of the complexities involved and the high administrative costs of implementation."[39] Since the use of interest to neutralise inflation would be tantamount to using a bigger 'evil' to fight a smaller one, and Islam does not encourage the introduction of new 'evils' to fight existing ones, as the Bangladeshi author, M.A. Hoque says,[40] the avenue of nominal interest should also be closed to the creditor. Hence, the question of nominal or real interest does not arise; any interest should be prohibited as *riba*.

In spite of these varying opinions, the Modernists so far have failed to have much impact on the debate on *riba*. Their views, and the 'exceptions' to the *riba* prohibition they have advocated, have been met by neo-Revivalist critics with both economic and scriptural counter arguments, and their position has been weakened. One of the leading Islamic banking theorists, M.N. Siddiqi, says:

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[36] Ishaque, "Islamisation in Pakistan", p.91. It was probably to overcome the problem of maintaining the value of its deposits and advances, that the Islamic Development Bank adopted the *Islamic Dinar* unit, which equals, at present, an SDR (Special Drawing Right) of the International Monetary Fund. By adopting this measure, the IDB is eliminating the possibility of large fluctuations in the value of its deposits or advances.

[37] CII, *Consolidated Recommendations*, p.12.

[38] Chapra, *Towards a Just Monetary System*, pp.39-42.

[39] Ibid., pp.39-40.

[40] Hoque, "Prohibition of Interest", p.46.

> Efforts of some pseudo-jurists to distinguish between *riba* and bank interest and to legitimise the latter [have] met with almost universal rejection and contempt. Despite the fact that circumstances force many people to deal with interest-based financial institutions, the notion of its essential illegitimacy has always remained.[41]

The position of the Modernists is further undermined by two factors: their inability to present a consistent theory of *riba* on the basis of the rationale of prohibition which is specified in the Qur'ān, and the rise of Islamic banking institutions inspired by neo-Revivalist thinking on the issue of *riba*, which have adopted the view that 'any interest is *riba*, and as such is prohibited'.

The neo-Revivalist view on riba and interest

The neo-Revivalist view is the dominant one in the contemporary debate. This view emphasises the legal form of *riba* as expressed in Islamic law, and insists that the words specified in the Qur'ān should be taken at their literal meaning, regardless of what was practised in the pre-Islamic period. According to this view, since the Qur'ān has stated that only the principal should be taken, there is no alternative but to interpret *riba* according to that wording. Therefore, the existence or otherwise of injustice in a loan transaction is irrelevant. Whatever the circumstances are, the lender has no right to receive any increase over and above the principal.[42]

Although several leading neo-Revivalists like Mawdūdi[43] and Sayyid Quṭb[44] have discussed to some extent the issue of injustice in *riba*, they have generally refrained from stating that it is injustice which is the *raison d'être* of the prohibition. According to Mawdūdi, "the contention that *ẓulm* (injustice) is the reason why interest on loans has been disallowed and hence all such interest transactions as do not entail cruelty are permissible, remains yet to be substantiated."[45]

Following this line of thinking, neo-Revivalist writers have interpreted *riba* in a way which would not allow any increase in a loan. Mawdūdi defines *riba* as "the amount that a lender receives from a borrower at a fixed rate of interest."[46] Perhaps one of the most important documents on Islamic banking, the CII (Council of Islamic Ideology) Report is more explicit: "There is complete unanimity among all schools of thought in Islam that the term *riba* stands for interest in all its types and forms."[47] Chapra states

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[41] Siddiqi, *Issues in Islamic Banking*, pp.9-10.

[42] See for instance, Abu Zahra, *Buḥūth fi al-Riba;* Mawdūdi, *Riba*.

[43] Mawdūdi, *Riba*.

[44] Quṭb, *Tafsīr Āyāt al-Riba*.

[45] Mawdūdi, "Prohibition of Interest in Islam", p.7. For Rāzi's view on the rationale of the prohibition, see Rāzi, *Tafsīr*, VII, p.94.

[46] Mawdūdi, *Towards Understanding the Qur'ān*, I, p.213.

[47] CII, *Consolidated Recommendations*, p.7.

that "*riba* has the same meaning and import as interest."[48] For these scholars, the prohibition of *riba*, interpreted as interest, is axiomatic. Mohammad Uzair, an Islamic banking theorist, asserts that interest in all its forms is synonymous with *riba*, and claims the existence of consensus on the issue:

> By this time, there is a complete consensus of all five schools of *Fiqh*...and among Islamic economists, that interest in all forms, of all kinds, and for all purposes is completely prohibited in Islam. Gone are the days when people were apologetic about Islam, and contended that the interest for commercial and business purposes, as presently charged by banks, was not prohibited by Islam.[49]

But the question remains, 'Is this interpretation of *riba* justified?' We do not contend that 'any increase over and above the principal' is *riba* irrespective of the circumstances of the loan or debt. Since the matter is more complex than appears on the surface, the difficulties involved will be highlighted in chapter 8 of this book. Whatever the value of the neo-Revivalist interpretation of *riba*, it is this interpretation which is the basis of current Islamic banking theory as well as practice. In the following chapters, various aspects of Islamic banking will be examined keeping this fact in mind. However, in chapter 8 the neo-Revivalist interpretation of *riba* will be looked at critically, arguing for an approach based on fresh *ijtihād*.

[48] Chapra, *Towards a Just Monetary System*, p.57.
[49] Uzair, "Impact of Interest Free Banking", p.40.

CHAPTER FOUR

PROFIT AND LOSS SHARING: MUḌĀRABA AND MUSHĀRAKA

Islamic banking theorists envisioned that the investment activities of the Islamic bank would be based on the two legal concepts of *muḍāraba* and *mushāraka*, alternatively known as Profit and Loss Sharing (PLS). These theorists contended that the Islamic bank would provide its extensive financial resources to the borrowers on a risk sharing basis, unlike the interest-based financing in which the borrower assumes all risks. However, in practice, Islamic banks generally have come to realise that PLS, as envisaged by the theorists, cannot be utilised extensively in Islamic banking due to the risks it imposes on the bank. This realisation has led Islamic banks to find ways by which they can limit the flexibility of these two concepts of PLS and transform them almost to risk-free financing mechanisms. This chapter examines how the two concepts of *muḍāraba* and *mushāraka* developed in Islamic law and how they are utilised in Islamic banking.

Muḍāraba in fiqh literature

Muḍāraba is a contract between two parties whereby one party called *rabb al-māl* (investor) entrusts money to a second party, called *muḍārib* for the purpose of conducting trade. The *muḍārib* contributes his labour and time and manages the venture according to the terms of the contract. One of the essential characteristics of this contract is that the profit, if any, will be shared between the investor and the *muḍārib* on a pre-agreed proportional basis. The loss, if any, should be borne by the investor alone.[1]

The Qur'ān has no direct reference to *muḍāraba*, though it uses the root *ḍ-r-b* from which *muḍāraba* is derived, fifty-eight times.[2] The verses in the Qur'ān which may have some bearing on *muḍāraba*, though admittedly in a distant way, denote 'travel' or 'travel for the purpose of trade.'[3] It has been claimed that even the Prophet and some of his Companions were engaged in *muḍāraba* ventures.[4] According to Ibn Taymiyya, Muslim jurists declared the lawfulness of *muḍāraba*, on the basis of certain reports attributed to

[1] Jazīrī, *Fiqh*, III, p.34; Saleh, *Unlawful Gain*, p.103; 'Abd al-Qādir, *Fiqh al-Muḍāraba*, pp.8-9; Abu Saud, "Money, Interest and Qiraḍ", p.66; El-Ashker, *The Islamic Business Enterprise*, p.75.
[2] Qur'ān 2:273; 3:156; 4:101; 5:106; 73:20.
[3] Asad, *The Message*, pp.92,905.
[4] Ibn Hishām, *al-Sīrat al-Nabawiyya*, I, p.188; Sarakhsi, *Mabṣūṭ*, XXII, p.18; Ibn Qudāma, *Mughni*, V, p.26.

some Companions but there is no authentic *ḥadīth* on *muḍāraba* attributed to the Prophet.[5] Ibn Ḥazm (d.456/1064), the founder of the Ẓāhiri school, emphasised this by saying: "Each chapter of *fiqh* has a basis in the Qur'ān and *sunna* except *muḍāraba* for which we did not find any basis whatsoever."[6] According to the Ḥanafi jurist, Sarakhsi (d.483/1090), *muḍāraba* was permitted "because people have a need for this contract."[7] The Māliki jurist, Ibn Rushd (d.595/1198), regards it as a special concession.[8] Although *muḍāraba* is not directly referred to in the Qur'ān or *sunna*, it is a tradition sanctioned and practised by the Muslims, and this form of commercial association appears to have continued throughout the early period of the Islamic era as the mainstay of the caravan and long distance trade.[9]

Muḍāraba was utilised mainly as an instrument of commerce, that is, buying and selling either in long distance (in another town) or local trade (in one's own town).[10] The Mālikis and the Shāfi'is insisted that *muḍāraba* was a purely commercial instrument. They would reject a *muḍāraba* which required, for instance, any manufacturing activity on the part of the agent. For them, such an arrangement would be a hire contract in which all profits and losses accrue to the investor, with the *muḍārib* being entitled to an equitable remuneration for his work.[11] Although the Ḥanafis viewed *muḍāraba* as a commercial arrangement, they did permit a mixed investment, that is, an arrangement whereby the investor entrusted a given sum of money to an agent, half or any other fraction of which was a *muḍāraba* investment with the balance either in the form of a loan, deposit, or *ibḍā'*.[12] The purpose of such arrangements was to extend the possible variations in the profit and risk.[13]

Capital. To avoid any dispute, the *muḍāraba* contract should specify unambiguously the amount of the capital. This can be realised if the amount of capital is stated in currency units.[14] The capital of the *muḍāraba* should not be a debt owed by the *muḍārib* at the time of the *muḍāraba* contract. None of the four Sunni schools of law permits a contract in which the creditor asks his debtor to set up a *muḍāraba* on the understanding that the capital of the venture would be a debt owed by the prospective *muḍārib* to the investor.[15] The reason for this appears to be that in such an arrangement the investor could easily use the *muḍāraba* as a means to recover the debt and possibly derive a benefit from it. Deriving a benefit from a debt is seen to be *riba* which is prohibited in Islamic law. According to Ibn Rushd, Mālik (d.179/796) did not allow that for fear that it might lead to the form of *riba* practised in the pre-Islamic period.[16] If the debtor is in financial difficulty, the creditor may exploit the debtor's desperate situation and may dictate unreasonable terms for the *muḍāraba* contract. The debtor may not have any option but to comply with the creditor's wishes. In order to avoid such exploitation, the jurists appear to have closed this avenue in the face of the investor.

The investor should hand over the *muḍāraba* capital to the *muḍārib*, in order for the contract to become valid.[17] The *muḍārib* is free to invest and use the capital within the terms of the *muḍāraba* contract which would generally specify the type of business engaged in, the duration of the venture, and the places where the *muḍārib* could conduct the business.

Management. The *muḍārib* manages the *muḍāraba* since by definition he provides his labour as capital to the venture. The *muḍārib* should have the necessary freedom in the management of the venture and all related decision making. In the Ḥanafi school of law, perhaps the most liberal school on this issue, *muḍāraba* is of two types as far as the *muḍārib*'s freedom in the management of the *muḍāraba* is concerned: unrestricted *muḍāraba* and restricted *muḍāraba*. In an unrestricted *muḍāraba* the *muḍārib* enjoys complete freedom to conduct the *muḍāraba* as he sees fit. He may travel with the capital, give the capital to a third party or even engage in a partnership (*mushāraka*) with others. The *muḍārib* may also mix *muḍāraba* capital with his own goods.[18] He may use the capital to buy any kinds of goods from anyone and at any time. He may sell the *muḍāraba* goods for cash or credit. He is free to hire anyone or anything in conducting the *muḍāraba*, or manage the capital in the interest of *muḍāraba* as he sees fit.[19] Even where the *muḍārib* is restricted, he is free to trade according to the practice of merchants.[20] The investor's interference in the management of the *muḍāraba* would hinder the *muḍārib*'s efficient performance, and as such should be avoided.[21] According to Mālik and Shāfi'i (d.204/820), if the investor stipulates that the *muḍārib* should not buy except from a particular person or a

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[5] Ibn Taymiyya, *Majmū' Fatāwa Shaykh al-Islām*, XXIX, p.101.
[6] Shawkāni, *Nayl al-Awṭār*, V, p.267.
[7] Sarakhsi, *Mabṣūṭ*, XXII, p.19.
[8] Ibn Rushd, *Bidāyat al-Mujtahid*, II, p.178.
[9] Qureshi, D.M. "Modaraba and its Modern Applications", p.9.
[10] Sarakhsi, *Mabṣūṭ*, XXII, pp.38-9.
[11] Udovitch, *Partnership and Profit*, p.186.
[12] *Ibḍā'* is a type of informal commercial collaboration in which one party entrusts his goods to the care of another, usually to be sold, after which the latter, without any compensation, commission, or profit, returns the proceeds of the transaction to the first party.
[13] Udovitch, *Partnership and Profit*, pp.188-9.
[14] Sarakhsi, *Mabṣūṭ*, XXII, p.33; Ibn Rushd, *Bidāyat al-Mujtahid*, II, p.178; Jazīrī, *Fiqh*, III, p.43; Saleh, *Unlawful Gain*, p.105.
[15] Ibn Qudāma, *Mughni*, V, p.73; Saleh, *Unlawful Gain*, p.105.
[16] Ibn Rushd, *Bidāyat al-Mujtahid*, II, p.179.
[17] Sarakhsi, *Mabṣūṭ*, XXII, p.84; Ibn Qudāma, *Mughni*, V, p.29.
[18] Sarakhsi, *Mabṣūṭ*, XXII, pp.39-40; Udovitch, *Partnership and Profit*, pp.198-201.
[19] In contrast, Shāfi'is and Mālikis restrict the scope of a *muḍārib's* activities to those allowed to him.
[20] Sarakhsi, *Mabṣūṭ*, XXII, pp.38-9.
[21] Ibn Rushd, *Bidāyat al-Mujtahid*, II, pp.179-80.

specified commodity the *muḍāraba* is void.[22] Abu Saud, a contemporary writer on Islamic banking, says:

> [The *muḍārib*] must have absolute freedom to trade in the money given to him and take whatever steps or decisions that he deems appropriate to realise the maximum gain. Any conditions restricting such liberty of action vitiate the validity of the act.[23]

Duration. The *muḍāraba* contract should not contain a term which specifies a fixed duration for the venture. Such a term would render the contract voidable, according to the Mālikis and Shāfi'is.[24] The Ḥanafis and Ḥanbalis, however, would allow such a clause.[25] The scholars who held the former view apparently thought that such a limitation of time might let some good opportunities slip from the hands of the *muḍārib* or upset his plans and as a result not realise the profit he was working for.[26]

The *muḍāraba* contract could be terminated by one party by informing the other of the decision. This is possible because for the majority of jurists the *muḍāraba* is not a binding contract.[27] There is no difference of opinion when this termination takes place before the *muḍārib* begins work on the *muḍāraba*. Shāfi'i and Abu Ḥanīfa (d.150/767) held the view that even after the *muḍārib* began the work either party could terminate it. Mālik, however, did not allow termination of the contract in such a case.[28] Where the *muḍāraba* became void, for whatever reason, the *muḍārib* should receive a just remuneration for the work he had done, and he would be treated as if there was no *muḍāraba* contract, but a contract of hire (*ijāra*).[29] Under the terms of a hire contract, he should be paid for his work.

Guarantee. The investor cannot demand any guarantee from the *muḍārib* to return the capital or the capital with a profit. Since the relationship between the investor and the *muḍārib* is a fiduciary one[30] and the *muḍārib* a trustworthy person, such a guarantee would be void.[31] If the investor insists on the *muḍārib's* provision of guarantee and stipulates it as a term of the contract, the contract would not be valid according to Mālik and Shāfi'i.[32]

Profit and loss sharing. *Muḍāraba* is essentially a partnership of profit, and its fundamental components are the association of work and capital.

[22] Ibn Qudāma, *Mughni*, V, p.69.
[23] Abu Saud, "Money, Interest and Qiraḍ", p.70.
[24] Jazīrī, *Fiqh*, III, p.41.
[25] Ibn Qudāma, *Mughni*, V, pp.69-70.
[26] Abu Saud, "Money, Interest and Qirad", pp.70-1.
[27] Ibn Rushd, *Bidāyat al-Mujtahid*, II, p.181.
[28] Ibid.
[29] Ibid., p.183.
[30] Saleh, *Unlawful Gain*, p.105.
[31] Ibn Qudāma, *Mughni*, V, p.68.
[32] Ibn Rushd, *Bidāyat al-Mujtahid*, II, p.179.

Profit for either party is justified on the basis of these two components.[33] The risk involved also justifies the profit in the *muḍāraba*. The investor risks losing part or whole of the capital whereas the *muḍārib* risks being unrewarded for the labour and effort, in the event that the venture does not realise any profit.

The contract of *muḍāraba* should assign a profit rate for each party. The rate should be a ratio, and not a fixed amount. Assigning a fixed amount, for example one hundred currency units, to either party invalidates the *muḍāraba*[34] due to the possibility that the profit realised may not equal the sum so stipulated.[35] Before arriving at a profit figure, the *muḍāraba* venture should be converted to money, and the capital should be set aside.[36] The *muḍārib* is entitled to deduct all business related expenses from the *muḍāraba* capital.[37]

The investor is liable only for the amount of capital he has invested in the venture. For this reason, the *muḍārib* is not allowed to commit the *muḍāraba* venture to any amount greater than the capital invested in it.[38] Any such commitment would require the agreement of the investor if he is to be liable. Failure to secure the agreement of the investor will render the *muḍārib* liable. Similarly, if the *muḍārib* contravenes any term of the contract he will be liable for any loss or expense resulting from the contravention.[39] Therefore, *muḍāraba* could be considered a contract where the investor enjoys limited liability unlike the *muḍārib* who bears an unlimited liability. Against this disadvantage from the point of view of the *muḍārib*, the investor has to bear any loss or expense arising from the *muḍāraba* venture if the *muḍārib* acts according to the terms of the contract and does not misuse or mismanage the capital entrusted to him.[40]

The above indicates that although the contract of *muḍāraba* has no basis in the Qur'ān or the *sunna* it was utilised to conduct trade by the earliest Muslims. The contract was developed by the jurists in the light of the commercial realities of their time and the broad *sharī'a* principle of equity. These terms and conditions relating to various aspects of the contract were meant to protect the interests of both the *muḍārib* and the investor.

Muḍāraba in Islamic banking

The following discussion is based mainly on the *muḍāraba* contracts of

[33] Sarakhsi, *Mabsūṭ*, XXII, p.18.
[34] Ibid., p.22.
[35] Ibn Qudāma, *Mughni*, V, p.39; Homoud, *Islamic Banking*, p.202.
[36] Ibn Rushd, *Bidāyat al-Mujtahid*, II, p.181; Ibn Qudāma, *Mughni*, V, p.57.
[37] Ibn Rushd, *Bidāyat al-Mujtahid*, II, p.181.
[38] 'Abd al-Qādir, *Fiqh al-Muḍāraba*, p.27.
[39] Sarakhsi, *Mabsūṭ*, XXII, p.47; Ibn Qudāma, *Mughni*, V, p.54.
[40] El-Ashker, *The Islamic Business Enterprise*, pp.76-7.

Islamic banks currently in operation in the Middle East. A *muḍāraba* contract is utilised in Islamic banking mostly for a short-term commercial purpose and for a specific venture. Those contracts available to the author often refer to the buying and selling of goods, which indicates the commercial nature of the contract.[41] The Islamic bank's clients enter into *muḍāraba* contracts with the bank. The *muḍārib* (client), having received financial support from the bank, purchases a certain quantity and quality of closely specified goods from a seller and sells them to third parties at a profit.[42] Prior to the approval of finance, the *muḍārib* provides the bank with all the details relating to the goods, the source from which they can be purchased and all the costs associated with the purchase. He presents to the bank the required financial statements regarding the expected sale price, cash flow and profit margin, which the bank studies before any decision is made on financing.[43] The bank would normally provide the required finance if it was satisfied with the expected profit margin on its advance.

Capital. The *muḍāraba* contracts of Islamic banks specify the amount of capital advanced for the venture.[44] Generally speaking, no cash is advanced to the *muḍārib*. The amount of capital is credited to the *muḍāraba* account which the bank opens for the purpose of managing the *muḍāraba*. Since *muḍāraba* generally is for the purchase of specified goods the bank itself makes the payment directly to the seller.[45] The funds advanced by the bank as capital are not at the disposal of the *muḍārib* and he cannot use them for any other purpose. However, Islamic banks, for instance, state in their *muḍāraba* contracts that the *muḍārib* should not use the advanced funds for any purpose other than that specified in the contract,[46] a clause which appears to be rather meaningless in practice.

Management. The *muḍārib* manages the *muḍāraba* and oversees the purchase, storage, marketing and sale of the goods.[47] The contract specifies in detail how to manage the *muḍāraba*. The *muḍārib* should ensure that correct descriptions of the goods are provided in the application for financing. He is personally responsible for any losses or expenses resulting from any mistakes in the specifications since the bank does not bear any such losses.[48] He should keep the goods insured against all risks and should store them appropriately.[49] In short, the *muḍārib* should comply with the detailed terms of the contract in relation to the management of the venture, such terms be-

[41] FIBE, *Contract of Muḍāraba*; IIBID, *Contract of Muḍāraba*.
[42] Ibid.
[43] IIBID, *al-Tamwil bi al-Muḍāraba*, pp.22-3; FIBE, *Contract of Muḍāraba*.
[44] FIBE, *Contract of Muḍāraba*; IIBID, *Contract of Muḍāraba*; JIB, *Contract of Muḍāraba*.
[45] IIBID, *Contract of Muḍāraba*.
[46] JIB, *Contract of Muḍāraba*; IIBID, *Contract of Muḍāraba*; FIBE, *Contract of Muḍāraba*.
[47] FIBE, *Contract of Muḍāraba*.
[48] Ibid.
[49] FIBE, *Contract of Muḍāraba*; IIBID, *Contract of Muḍāraba*.

ing generally dictated by the bank.

Duration. Since a *muḍāraba* contract is generally used for a short-term commercial purpose, its duration can easily be estimated and is generally specified in such contracts by Islamic banks.[50] Since the profit margin on the bank's advance is calculated by taking into consideration the maturity of the contract, it is of the utmost importance for the Islamic bank that the *muḍāraba* be liquidated and the bank's capital and return on the capital be paid on time as specified in the contract.[51] From the bank's point of view, any extension of the time specified in the contract would put the bank at risk because it would not allow the bank to alter the profit ratio originally agreed upon. Since the profit ratio remains constant throughout the *muḍāraba* period, an extension could mean erosion of the return on the capital advanced. The funds would remain tied to the *muḍāraba* without being utilised in another investment activity. Some Islamic banks even go so far as to suggest that if the *muḍārib* does not fully utilise the funds during the specified period, he should compensate the bank for the loss. The contract of the International Islamic Bank for Investment and Development, for instance, states: "The contract would automatically be cancelled by its expiry date. The *muḍārib* must return the funds of the *muḍāraba* to the investor with any compensation for keeping the funds during the time of the contract without making them productive."[52]

Guarantee. The Islamic bank takes many steps to ensure that its capital advance and the expected return on this capital is given to the bank on time as specified in the contract. This is normally achieved by means of guarantees either from the *muḍārib* or from a third party. Although Islamic law does not allow the investor to demand guarantees from the *muḍārib*,[53] Islamic banks generally do seek various forms of guarantees. They insist, however, that the guarantees are not made to ensure the return of the capital but to ensure that the performance of the *muḍārib* is in accordance with the terms of the contract.[54] The International Islamic Bank for Investment and Development requires applicants for *muḍāraba* finance to state the type of guarantees they can provide to the bank.[55] One of the terms of the *muḍāraba* contract of the Faisal Islamic Bank of Egypt is that "if it is proved that the *muḍārib* misused or did not properly protect the goods or funds or acted contrary to the investor's terms, the *muḍārib* should bear the loss, and should provide guarantee against such a loss."[56] In the event that the *muḍārib* is liable for such a loss, the guarantor is required to compensate the

[50] FIBE, *Contract of Muḍāraba*; JIB, *Contract of Muḍāraba*; IIBID, *Contract of Muḍāraba*.
[51] JIB, *Contract of Muḍāraba*; IIBID, *Contract of Muḍāraba*.
[52] IIBID, *Contract of Muḍāraba*.
[53] Ibn Qudāma, *Mughni*, V, p.68.
[54] FIBS, *Bank Faiṣal al-Islāmi al-Sūdani*.
[55] IIBID, *al-Tamwil bi al-Muḍāraba*, p.22.
[56] FIBE, *Contract of Muḍāraba*; IIBID, *Contract of Muḍāraba*.

bank. If the guarantees provided are insufficient, the *muḍārib* should provide additional guarantees within a specified period.[57]

In addition to the guarantees there are other means available to the Islamic bank to safeguard its capital advances. The *muḍārib* is required to submit periodic progress reports on both the general performance of the *muḍāraba* and the cash flow.[58] He is also required to keep all accounting records relating to the contract, and to allow the representatives of the bank to examine these records and audit them, and to do a stocktake in his stores and warehouses at any time without any objection.[59] He should provide the bank with the balance sheet, profit and loss account, and periodic progress reports relating to the disposal of the goods to ensure that these goods are utilised as specified in the contract.[60] Any delay in submitting the balance sheet or periodic progress report would lead to a decrease in the profit-share of the *muḍārib* in proportion to the period of delay.[61]

If the *muḍārib* fails to achieve the projected cash flow or distributable revenue, the bank itself may assume the management of the project.[62] The bank may also demand the liquidation of the *muḍāraba* if it appears to the bank that there is no benefit in continuing the contract or if the *muḍārib* has contravened the terms. This can be done without any prior warning or recourse to law.[63]

Profit and loss sharing. The Islamic bank agrees with its *muḍāraba* client on the profit-ratio which is specified in the contract.[64] The ratio would depend *inter alia* on the bargaining power of the client, the profit forecast of the *muḍāraba*, the market interest-rate, the personal characteristics of the client and the marketability of the goods as well as the duration.[65] If the *muḍāraba* does not result in any profit, the *muḍārib* does not receive any remuneration for his labour.[66] In case of loss, the bank bears the loss as long as it is not proved that the *muḍārib* misused or mismanaged the *muḍāraba* funds or acted contrary to any of the terms of the investor. If proved so, the *muḍārib* shall bear the loss,[67] in which case a guarantee with respect to the liability should be provided to the bank.[68]

This apparent undertaking of the bank to bear any loss, however, should

[57] FIBE, *Contract of Muḍāraba.*
[58] Ibid.
[59] Ibid.
[60] Ibid.
[61] Ibid.
[62] MFI, "Principles of Islamic Banking", pp.22-7.
[63] JIB, *Contract of Muḍāraba.*
[64] FIBE, *Contract of Muḍāraba*; JIB, *Contract of Muḍāraba.*
[65] Interviews with Ḥusain Kāmil (FIBE) on 3.12.1989, and Gharīb Nāṣer (IIBID) on 6.12.1989.
[66] IIBID, *Contract of Muḍāraba.*
[67] FIBE, *Contract of Muḍāraba*; JIB, *Contract of Muḍāraba*; IIBID, *Contract of Muḍāraba.*
[68] FIBE, *Contract of Muḍāraba.*

not be taken at face value. Through various means the Islamic bank almost eliminates the uncertainty involved in a pure *muḍāraba* venture. The actuarial risk in the venture as utilised in Islamic banking is quantifiable and insurable. For this reason, it could be suggested that the Islamic bank's *muḍāraba* differs little from any other low risk or risk free investment operation.

The discussion on *muḍāraba* as practised in Islamic banking indicates that it is mostly used for short term commercial purposes where the outcome is almost certain. There is no actual transfer of the capital to the *muḍārib* to conduct a business freely. The bank in minute detail prescribes how to sell the goods. Any contravention of the terms of the contract would make the *muḍārib* liable for any losses. The bank specifies a duration for the contract. It also demands various forms of guarantees to ensure that its capital and return on capital are paid on time although the bank does not explicitly say so. In profit and loss sharing, theoretically, the bank bears all losses, but in practice, because of the nature of the *muḍāraba* contract of the Islamic bank and its terms, such a loss is unlikely to occur frequently. From this it may be gleaned that the *muḍāraba* contract of the Islamic bank is significantly different from the *muḍāraba* contract as generally envisaged in the schools of law, or as envisaged by the Islamic banking theorists as a form of venture capital financing, or industrial finance for development.

Mushāraka in fiqh literature

'Mushāraka' (partnership) is the second basic Profit and Loss Sharing (PLS) concept in Islamic banking. The Qur'ān has used the root of the term *mushāraka*, that is, *sh-r-k*, approximately 170 times, though none of these verses has used the term strictly in the sense of partnerships in a business venture. Nevertheless, on the basis of several verses of the Qur'ān, particularly the verses 4:12 and 38:24, as well as some reports attributed to the Prophet and his Companions, jurists have justified the validity of *mushāraka* in business ventures.[69]

Several sayings attributed to the Companions indicate that some form of partnership was practiced by the earliest Muslim community.[70] These sayings merely refer to the existence of a form of partnership, without indicating any terms, conditions or concepts which may have been associated with this partnership. Given that these reports do not provide any details as to the valid terms and conditions of such partnership contracts as came to be known later in Islamic law, such terms and conditions as elaborated in *fiqh* would be the product of *ijtihād* by Muslim jurists.

[69] Ibn Qudāma, *Mughni*, V, p.3; Sābiq, *Fiqh al-Sunna*, III, p.355.
[70] Shawkāni, *Nayl al-Awṭār*, V, p.264-5.

In *fiqh*, the concept of *mushāraka* is used in a much wider sense[71] than is used in Islamic banking.[72] In this chapter, however, we are concerned with one type of *mushāraka*, that which is known in *fiqh* as *'inān* finance partnership *(sharikat 'inān fi al-māl).* Since it is this form which is seen to be the most appropriate for the Islamic banks, the use in this text of the term *'mushāraka'* is in this sense of partnership.

Capital. The *mushāraka* capital should be specified clearly in the contract[73] and in monetary terms.[74] Each partner may contribute a certain percentage of the capital and partners are not required to contribute to the capital equally. According to the Ḥanafi jurist Qudūri (d.428/1037), *mushāraka* is valid regardless of whether each partner's investment is equal to that of the others.[75]

Management. The discussion of *mushāraka* in *fiqh* indicates that it is a contract which is normally entered into by equal partners, that is, both partners agree on the terms of the contract, and one would not dictate the terms to the other.[76] Unlike in *muḍāraba,* where the investor remains the stronger party in view of his provision of the capital, financing in *mushāraka* is provided by both parties, even though in some cases one party may provide a higher percentage of the total capital contributed. As an example of the shared authority enjoyed by the partners, according to the Ḥanafis, each of the partners can delegate the function of selling, buying, renting and hiring to an agent, but the other partner has a right to relieve the agent of that function.[77] Considerable latitude is given in *fiqh* to the partner who is managing the *mushāraka.* The partner can conduct the business in any way which would help realise the purpose of the agreement, that is, to make a profit. He should not undertake any action which would be contrary to this basic purpose. Ibn Qudāma stated several things which the partner should not do. Among them were, for instance, freeing a slave (presumably one who is owned by the partners), and lending money belonging to the partnership, the reason being that such actions, although good in themselves, are not conducive to the realisation of the *mushāraka* purpose, that is, realising a profit.[78]

The Ḥanafis apparently are inclined to give more freedom to the managing partner. According to them, the partner who is not involved in buying and selling cannot even give an item belonging to the *mushāraka* as a pledge or security. If he does, it is not lawful, and he is liable. On the other hand,

71 Jazīri, *Fiqh*, III, pp.62-76; Sābiq, *Fiqh al-Sunna*, III, pp.354-69.
72 'Aṭiyya, *Muḥāsabat al-Sharikāt*, pp.56-8.
73 Ibn Qudāma, *Mughni*, V, pp.16-20.
74 The Ḥanafi view: Jazīri, *Fiqh*, III, pp.78-9.
75 Udovitch, *Partnership and Profit*, p.120.
76 Ibn Qudāma, *Mughni*, V, pp.14-8; Ibn Rushd, *Bidāyat al-Mujtahid*, II, pp.189-91.
77 Jazīri, *Fiqh*, III, p.87.
78 Ibn Qudāma, *Mughni*, V, p.22.

the managing partner has a right to give goods belonging to the *mushāraka* as security, and to accept pledges from others.[79] The Shāfi'is and Ḥanbalis take the view that each partner can conduct the affairs of the partnership to serve the interests of the *mushāraka* according to the customary practice of merchants.[80] According to Ibn Qudāma, the partner can do whatever is in the interest of the business by virtue of the partnership because this is the customary practice of merchants.[81]

Duration. Mushāraka, like *muḍāraba*, can be for a short period of time to achieve a specific purpose. The contract may be for the purpose of purchase and sale of a particular commodity and to share in the profit of the venture. If the outcome is a loss, it has also to be shared by the partners. *Mushāraka* may also be utilised for long-term projects, in which case, it may continue indefinitely. The *mushāraka* can be terminated by either partner by informing the other of the decision at any time.[82]

Guarantee. All the four Sunni schools of law maintain that the partner is a trusted person. Based on this concept of 'trust', one partner cannot demand any guarantee from the other. According to the Ḥanafi jurist Sarakhsi, "each of them [partners] is a trusted person over what is entrusted to him. A stipulation in the contract that a trusted person provide a guarantee *(ḍamān)* would be regarded as null and void."[83]

Profit and loss sharing. The profit share of each partner should be a percentage, not a fixed amount. According to the Ḥanafis and Ḥanbalis, the percentage should be specified clearly in the contract. Stipulating a fixed amount for a partner is not allowed for the reason that the total profit realised may not exceed the fixed amount, in which case the other partner may not get a share of that profit.[84] As for the Shāfi'is, there is no need to specify the profit share in the contract, since they do not allow a divergence between the capital contribution and the profit ratio. According to the Shāfi'i jurist Nawawi (d.676/1277), "the profit and loss should be in proportion to the capital provided, whether or not the labour provided by the partners is equal."[85]

Whereas the Shāfi'is do not allow the profit sharing ratio to be different from the capital contribution ratio, there is considerable flexibility in the determination of that ratio within the Ḥanafi and Ḥanbali schools. The partners may share in the profit on an equal or unequal basis. A partner contributing one-third of the capital of *mushāraka*, for instance, can have one-half or more of the profits. According to the Ḥanafi jurist Kāshāni

79 Jazīri, *Fiqh*, III, p.87.
80 Ibid., p.89.
81 Ibn Qudāma al-Maqdisi, *al-Kāfi fi Fiqh al-Imām Aḥmad b. Ḥanbal*, II, p.260.
82 Kāshāni, *Badā'i' al-Ṣanā'i'*, VI, pp.77-8.
83 Sarakhsi, *Mabṣūṭ*, XI, p.157.
84 Ibn Qudāma, *Mughni*, V, p.38; Kāshāni, *Badā'i' al-Ṣanā'i'*, VI, p.59.
85 Nawawi, *Minhāj*, II, p.215.

(d.587/1191), "it is not necessary that in *'inān* [a form of *mushāraka*], the profit should be divided equally among the partners. It is, therefore, lawful to divide the profit equally or unequally. The principle is that the partner deserves the profit either by means of the provision of money capital or labour, or liability."[86]

No flexibility exists in *mushāraka* with respect to loss sharing vis-à-vis the capital contribution ratio in any of the four Sunni schools of law,[87] as is indicated by the legal maxim, "loss sharing should strictly follow the capital contribution ratio."[88] According to Jazīri, "if one partner stipulates that the other should bear more than his capital contribution ratio justifies, the contract is null and void."[89] This principle is reportedly expressed by the fourth caliph 'Ali b. Abi Ṭālib (d.40/660): "The profit is to be shared as agreed upon in the contract, while the loss is to be shared according to the capital contribution."[90]

Mushāraka in Islamic banking

Mushāraka, described by the International Islamic Bank for Investment and Development as one of "the best financing methods of Islamic banks"[91] is a method based on the participation of the bank and the seeker of finance (the potential partner) for a given project, and ultimately, participation in the profit or loss arising. The terms and conditions should be in accordance with the principles pertaining to *mushāraka*, and shall be agreed upon beforehand, between the bank and the partner. Generally speaking, the bank would contribute to the capital of the venture and leave the management to the partner.[92] *Mushāraka* has been conceived in Islamic banking as a mechanism which could bring together labour and capital for the socially beneficial production of goods and services. It can be used in all occupations which are run according to profit motives. Although several writers on Islamic banking appear to use the term *mushāraka* in the sense of participation in investment projects,[93] the term is used by Islamic banks in a much broader sense. For these banks, *mushāraka* can be utilised for purely commercial purposes which are usually of a short term nature, or for participation in the equity of medium to long term projects. The types of *mushāraka* utilised in Islamic banking are (i) commercial *mushāraka*, (ii) decreasing participation, and (iii) permanent participation.

[86] Kāshāni, *Badā'i' al-Ṣanā'i'*, VI, p.62.
[87] Ibn Qudāma, *Mughni*, V, p.37.
[88] Sābiq, *Fiqh al-Sunna*, III, p.357.
[89] Jazīri, *Fiqh*, III, p.77.
[90] Shawkāni, *Nayl al-Awṭār*, V, p.266.
[91] IIBID, *al-Tamwīl bi al-Mushāraka*, p.6.
[92] Ibid.
[93] Mukhtār, *Bunūk al-Istithmār*, pp.300-2.

Commercial mushāraka. A commercial *mushāraka* agreement is normally for one specific purpose, such as the purchase and sale of a machine or a commodity. Both the bank and its partner contribute to the capital but it is the partner who undertakes the management of the buying, selling, marketing and account-keeping related to the transaction. The bank's function is to finance its share of the transaction, provide necessary banking services like the opening of letters of credit where necessary, and to monitor the progress of the *mushāraka* through the current account and other periodic progress reports from the partner.[94]

A commercial *mushāraka* contract is useful for an Islamic bank as it is liquidated quickly, turnover of the capital is higher, and therefore, the return will also be generally higher. The bank's activities in advancing finance on the basis of commercial *mushāraka* to a large number of ventures, serve to diversify and minimise risk in its investment operations.[95]

There is no fixed ratio of capital contribution to the commercial *mushāraka*. According to Ḥusain Kāmil of the Faisal Islamic Bank of Egypt[96] and Gharīb Nāṣer of the International Islamic Bank for Investment and Development,[97] the ratio depends largely on the personal characteristics of the partner, the amount of capital involved, the security provided as well as the risk involved in the venture. In the Faisal Islamic Bank of Sudan, for instance, the partner's capital contribution could be as much as forty percent, particularly in transactions related to local and foreign trade.[98]

There is generally a fixed time for the commercial *mushāraka* to be completed. Tadamon Islamic Bank says:

> An approximate time is generally specified to liquidate the *mushāraka*. If the client is unable to manage the venture and cannot liquidate it on time, then, in the absence of any acceptable excuse, the bank may at its discretion manage the *mushāraka* in lieu of a profit share, and liquidate it.[99]

Decreasing participation. Decreasing participation is defined as a partnership whereby the bank enables the partner to gain ownership of the project gradually, according to the conditions set out in the *mushāraka* contract.[100] Clients of this form of *mushāraka* are those who are not interested in the bank's continued co-participation in their projects and who wish to gain ownership of the project in the shortest possible time. This type of *mushāraka* is utilised to participate in new industrial or agricultural projects

[94] 'Awaḍ, *Dalīl al-'Amal fi al-Bunūk al-Islāmiyya*, pp.40-5; FIBS, *Bank Faiṣal al-Islāmi al-Sūdāni*, p.35; Ṭā'il, *al-Bunūk al-Islāmiyya*, pp.91-2.
[95] FIBS, *Bank Faiṣal al-Islāmi al-Sūdāni*, p.35.
[96] Interview with Ḥusain Kāmil of FIBE on 3.12.1989.
[97] Interview with Gharīb Nāṣer of IIBID on 6.12.1989.
[98] FIBS, *Bank Faiṣal al-Islāmi al-Sūdāni*, p.35.
[99] TIB, *al-Tājir al-Ṣadūq*, p.18.
[100] IAIB, *100 Questions*, p.99.

or services, rather than commercial ventures. The Islamic bank finances part of the capital on condition that the bank receives a percentage of the profit realised from the project for a period of time agreed upon in advance. During this period, the share of capital which the bank provides is repaid in instalments.[101] Decreasing participation could be undertaken in one of the following ways:

- The bank and the client agree on the capital contribution of each partner to the *mushāraka* and on the terms of the contract. When the *mushāraka* contract is finalised, another separate contract is signed, which would allow the bank to sell its share to the client or any other party. This second contract will state the method of this sale and its duration. In this case, the buyer should pay for the bank's share in one instalment.[102]
- The bank and the client determine that their investment in the *mushāraka* would be in the form of shares representing the total value of the *mushāraka*. Each partner would receive profit based on the number of shares he owns. The client is free to purchase from the bank a number of its shares each year leading to a gradual decrease in the number of shares the bank owns until the client is able to purchase all of the bank's shares. The client then becomes the sole owner of the *mushāraka* venture.
- The bank agrees with its client on the financing of a project either totally or partially from the bank's own resources on condition that the bank receives its share of the profit regularly and retains the partner's share of the net profit, or a portion of it to cover the finance advanced by the bank.[103]

Although the three forms were allowed by the Islamic Banking Conference held in Dubai in 1979, the last form of decreasing participation, according to al-Siddīq Muḥammad al-Amīn al-Ḍarīr, has some similarity to *riba* as the bank enters as a party to this transaction from the very beginning, on condition that it regains all of the finance it advanced, and on top of that, receives a percentage of the profit from the projects.[104] Nevertheless, all three forms are apparently practised by Islamic banks like the International Islamic Bank for Investment and Development and the Tadamon Islamic Bank.

Permanent participation. Permanent participation is defined as a *mushāraka* contract where the bank finances a portion of the capital of a defined project as a shareholder, and participates in the management and supervision of the project with its partner, on condition that the bank shall share in the profit or loss of the project as agreed upon in the contract.[105] The term 'permanent' does not indicate perpetuity, since this form of participation remains only until the project comes to an end, or until the time specified for the *mushāraka* has expired.

[101] FIBS, *Bank Faiṣal al-Islāmi al-Sūdāni*, pp.35-6.
[102] TIB, *al-Tājir al-Ṣadūq*, p.19.
[103] Ibid., pp.18-9; IIBID, *al-Tamwīl bi al-Mushāraka*, pp.19-20; KFH, *A Collection*, pp.69-70; IAIB, *al-Mawsū'at al-'Ilmiyya*, V, pp.325-6.
[104] TIB, *al-Tājir al-Ṣadūq*, p.19.

The following discussion largely relates to the commercial *mushāraka* contract which is the most common form of *mushāraka* utilised in Islamic banking,[106] although most of the points discussed here would be applicable to the other two forms of *mushāraka*, that is, decreasing participation and permanent participation.

Capital. Islamic banks generally provide part of the capital of the *mushāraka* venture, and the client provides the rest. There is no particular ratio set for this purpose. According to the Tadamon Islamic Bank, the ratio of the bank's share to that of the client is in accordance with each individual agreement and taking into consideration the client's financial situation. Whereas the bank requires the most able (rich) to pay a higher percentage of the capital, it does not require the same from the less able clients, but determines the percentage on a case by case basis. In some cases, the bank's share of financing can reach ninety percent of the total finance.[107]

Conduct of mushāraka: terms and conditions. The *mushāraka* is governed by the contract which states in detail the terms and conditions. These ensure that the bank's share of capital plus the return on it as expected in the contract are given to the bank upon maturity. Examples of the terms which indicate the nature of the restrictions within which the partner manages the *mushāraka* are outlined below.

The partner should store the *mushāraka* goods under joint supervision and none of the goods should be disposed of until after the sale price is entered into the *mushāraka* account.[108] The partner manages the *mushāraka* and sells the goods on the best possible terms.[109] The goods should be sold for cash and at a price agreed upon by both the bank and partner, which at times is even stated in the contract.[110] The partner should not sell the goods at a lower price than that agreed upon in the contract, unless there is written agreement from the bank. If the client sells them at a lower price without this agreement, he must reimburse the bank with the difference.[111] The partner should keep separate and proper accounting records for the *mushāraka* supported by relevant documents and legally acceptable in-

[105] Ṭā'il, *al-Bunūk al-Islāmiyya*, p.92; IIBID, *al-Tamwīl bi al-Mushāraka*, p.17.
[106] Interview with A. Nofal of FIBE on 4.12.1989.
[107] TIB, *al-Tājir al-Ṣadūq*, p.17.
[108] TIB, *Contract of Mushāraka*.
[109] Ibid.
[110] Ibid.
[111] FIBE, *Contract of Mushāraka*.

voices.[112] The bank has the right to conduct a stocktake of the goods at any time without objection by the client.[113] The bank has the right to check the accounting records of the client at any time the bank considers suitable.[114] The partner should submit periodic reports stating the goods sold and the balance in the warehouse.[115] The bank has a right to demand such reports whenever it sees fit.[116] The partner must keep all the goods fully insured against all risks throughout the duration of the *mushāraka*.[117] He cannot mix *mushāraka* goods with his own goods without the permission of the bank nor may he give the *mushāraka* goods, lend them or borrow any money by using them as collateral.[118] He cannot give any of his personal assets as security to a third party unless he has written authorisation from the bank.[119]

Guarantee. Although the schools of law do not allow any guarantee to be demanded from a partner as he is a 'trusted person', some Islamic banks, however, require their partners to provide guarantees to safeguard the bank's interest in the *mushāraka*. As the contract of *mushāraka* of the Faisal Islamic Bank of Egypt puts it:

> The first party [the bank] has a right to demand from the second party [the partner] the provision of additional guarantees acceptable to the first party [in case the first party considers that the guarantees already provided are not sufficient]. This should be within a week of giving notice to the second party... without any objection or deferment.[120]

The types of guarantees the Islamic banks require from their partners are varied, and in the following, we list some examples:

- a signed and undated cheque which the client himself submits to the bank. The amount of the cheque will be equal to the value of the bank's investment in the *mushāraka*. The bank will not use the cheque unless the partner acts in contravention of the terms of the contract.[121]
- the bills and invoices resulting from the sale of *mushāraka* goods to third parties, apparently on a deferred payment basis, must be deposited with the bank. If debtors (third parties) default on payment for the goods, the bank will be able to collect the debt either by deducting the amount from their accounts with the bank or otherwise.[122] Some banks require the partner to deposit with the bank cheques to the value of the sale of the goods to third parties as a guarantee. If the third parties do not pay, the bank can cash the cheques and, therefore, obtain payment from its partner.[123]
- the bank has a right to keep any cash balances, documents or commercial paper belonging to the partner which are deposited with the bank, in the event that the partner does not pay the bank's share by the due date.[124]
- the bank regards itself as the owner of the *mushāraka* goods from the purchase of these goods until they are sold.[125]
- in case the *mushāraka* goods are sold on a deferred payment basis to third parties, the bank has a right to demand that the partner be a guarantor and give an absolute guarantee (*kafāla muṭlaqa*)[126] of the debt owed by the third party.

112 TIB, *Contract of Mushāraka.*
113 FIBE, *Contract of Mushāraka.*
114 IIBID, *Contract of Mushāraka.*
115 FIBE, *Contract of Mushāraka.*
116 TIB, *Contract of Mushāraka.*
117 FIBE, *Contract of Mushāraka.*
118 JIB, *Contract of Mushāraka.*
119 FIBE, *Contract of Mushāraka.*
120 Ibid.
121 IIBID, *Contract of Mushāraka.*
122 Banque Misr, *Contract of Mushāraka.*

At times it appears that the bank attempts to keep itself away from any problems which might lead to losses. The contract of *mushāraka* of the Faisal Islamic Bank of Egypt states:

> Any liabilities arising due to the client's non-compliance with the laws in force in the country pertaining to the *mushāraka* goods are the sole responsibility of the client, not the bank. Even the expenses arising due to the cancellation of documentary credit [in the case of import], or the exporter's refusal to export, will be the sole responsibility of the client.[127]

One wonders, if it were a real partnership, as discussed in *fiqh*, whether the bank has any moral right to throw all such responsibilities onto the shoulders of its partner.

Duration. Since most of the *mushārakas*, particularly the commercial type[128] are apparently of a short term nature, and for a specific purpose, the contracts specify a duration for each one. If the duration specified in the contract is not sufficient, then it can be extended with the agreement of both parties.[129] The *mushāraka* can be terminated by the agreement of both parties on condition that the client pays to the bank all his liabilities arising due to this termination.[130] According to the Jordan Islamic Bank, the bank can demand liquidation of the *mushāraka* if it appears to the bank that its continuation is futile, or if the client contravenes any term of the contract. The bank can do this without any warning or recourse to law.[131]

123 IIBID, *Contract of Mushāraka.*
124 FIBE, *Contract of Mushāraka.*
125 IIBID, *Contract of Mushāraka.*
126 JIB, *Contract of Mushāraka.*
127 FIBE, *Contract of Mushāraka.*
128 IIBID, *Contract of Mushāraka.*
129 Banque Misr, *Contract of Mushāraka.*
130 Ibid.
131 JIB, *Contract of Mushāraka.*

The Islamic bank realises the importance of the time value of money and insists in its *mushāraka* operations that the client pay the bank's share of the profits plus capital on the due date specified in the contract.[132] In case there is any delay, the client's share of profits, which is given as a management fee, may be decreased. In the same way, if the client pays the sum owing before maturity, the share of profits given as a management fee may be increased.[133]

Profit and loss sharing. The Islamic banks do not follow a uniform method in sharing the profits of ventures they finance on a *mushāraka* basis. Profit sharing would largely depend on the role of the partner in the management of the project, and the capital contribution of the partner and the bank. The application for *mushāraka* financing (for commercial purposes) of the International Islamic Bank for Investment and Development proposes the sharing of the pre-tax profits of the *mushāraka* as follows: (i) a certain percentage for the partner for his efforts in buying and selling, storage, and collection of debts related to *mushāraka*; (ii) a certain percentage for the bank for its supervision and management; and (iii) a certain percentage for the capital contributed to the venture (according to the ratio of capital contribution by each partner).[134]

The Jordan Islamic Bank in its profit sharing percentages does not state any percentage for management. It merely specifies that the net profit will be shared between the bank and the partner, according to the agreed upon ratio in the *mushāraka* contract.[135] The Banque Misr (Islamic Branches) *mushāraka* contract states that the net profit is to be distributed as follows:[136] (i) a percentage for the bank against its banking services; and (ii) a percentage for the partner against marketing the goods and management. A percentage of the balance will be allocated for the bank and for the partner.

The basis of profit distribution, according to the practice of the Faisal Islamic Bank of Egypt is as follows:[137] (i) the profit is defined as net profit after deducting all expenses; and (ii) a portion of this profit is given to the partner for his labour and effort (alternatively known as a management fee). The balance is distributed between the bank and the partner. In case of losses, these are distributed in proportion to the capital contribution of each party.

The portion of profit that is given to the partner for management varies from one *mushāraka* to another depending upon the amount of work involved and the level of expertise required of the partner. It would be expected that the greater the amount of work and the higher the level of expertise, the higher the percentage. In the case of the Faisal Islamic Bank of Egypt, this rate ranges between twenty and sixty percent of the profit.[138] In the Tadamon Islamic Bank of Sudan, the partner's share of profit for his management increases or decreases depending on the extent of the management work, and the time required to complete the final liquidation of the venture. This percentage ranges between fifteen percent and forty-five percent.[139]

If there is any loss at the end of the *mushāraka*, which is not the result of misuse or mismanagement or contravention of the terms of the contract on the part of the client, the loss should be shared between the two parties according to their capital contribution.[140] However, in cases where the loss results from any misuse, mismanagement or contravention of the terms of the contract on the part of the client, the client is liable for the loss.[141]

The above discussion indicates that *mushāraka* is used in Islamic banking in various forms, the most important of which for the Islamic bank appears to be the short-term commercial *mushāraka*, although other forms of *mushārakas* are utilised. In *mushāraka* financing, both the bank and the partner contribute to the capital, and it is the bank which dictates how the *mushāraka* is to be conducted, thus ensuring that the bank receives its initial investment plus the return on capital (profit). The bank also seeks various forms of guarantees to protect its interest in the venture and appears to attempt to put all risks associated with the management of the *mushāraka* onto the partner. The bank also specifies a time limit for the *mushāraka*. There does not appear to be a uniform method of profit and loss sharing among Islamic banks, although the methods used by various banks are somewhat similar.

Extent of the use of muḍāraba and mushāraka in Islamic banking

In the literature on Islamic economics and banking published during the 1960s and early 1970s, Islamic banks were conceived as financial institutions which base their whole 'loan' business on the principle of Profit and Loss Sharing (PLS) with the entrepreneurial partners. However, the Islamic banks established so far are not pure PLS banks, but also make extensive use of other methods of financing, like leasing of capital goods or mark-up trading.[142] The extent of PLS financing is shown by Homoud, a theoreti-

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[132] FIBE, *Contract of Mushāraka.*
[133] Ibid.
[134] IIBID, *Application for Mushāraka Financing (Trading).*
[135] JIB, *Contract of Mushāraka.*
[136] Banque Misr, *Contract of Mushāraka.*
[137] El-Ashker, *The Islamic Business Enterprise*, pp.133-4.
[138] Ibid.
[139] TIB, *al-Tājir al-Ṣadūq*, p.18.
[140] Banque Misr, *Contract of Mushāraka*; FIBE, *Contract of Mushāraka*; JIB, *Contract of Mushāraka.*
[141] Banque Misr, *Contract of Mushāraka*; FIBE, *Contract of Mushāraka*; JIB, *Contract of Mushāraka.*
[142] Nienhaus, "Profitability of Islamic PLS Banks", p.37.

cian on Islamic banking, whose views are expressed in the following summary of the experience of Islamic banks:

> The Islamic banks practise *muḍāraba* with utmost caution. The banks can only rarely find trustworthy people. There is no law in Islamic countries which regulates the relationship between the investor and the *muḍārib*, and there is nothing to prevent the *muḍārib* from misusing the funds by thousands of unlawful means....The grim result is that the Islamic banks' utilisation of this method of financing has contracted sharply, and is being replaced by other methods of financing which do not help to realise the objectives of the *sharī'a*.[143]

According to 'Abd al-Qādir al-'Ush of the Jordan Islamic Bank (JIB), the JIB attempted to utilise the *muḍāraba* to invest its funds but after many cases of losses, had to limit the use of *muḍāraba* sharply.[144] Where Islamic banks use *muḍāraba* and *mushāraka*, they are on a very small scale, and even then, it appears that the operations are almost risk-free as in the case of short-term commercial *muḍāraba* and *mushāraka*, placement of funds on a short-term basis with international financial institutions and with the government. Among the Islamic banks which use *muḍāraba* and *mushāraka*, though not necessarily as pure PLS operations, the Dubai Islamic Bank, for instance, had three percent of its investment funds in 1989 in these operations.[145] Some Islamic banks' annual reports do not even mention the term *muḍāraba*, as in the case of the Bahrain Islamic Bank (BIB), and where the term *mushāraka* is used it is in real estate ventures.[146] The Faisal Islamic Bank of Egypt (FIBE), for instance, utilises *muḍāraba* with the Egyptian Central Bank as a *muḍārib* to import necessary foodstuffs and the like, a *muḍāraba* where there is no risk of loss at all. According to Ḥusain Kāmil and A. Nofal of FIBE, the Faisal Islamic Bank of Egypt (FIBE) had five hundred million Egyptian pounds placed with the Central Bank of Egypt on a *muḍāraba* basis in 1989.[147] But this form of 'risk-free' *muḍāraba* is hardly any different from any other pre-determined return-based financing. On the other hand, one would expect a development bank like the Islamic Development Bank (IDB) to provide significant amounts of the funds at its disposal on a PLS basis. In fact, interestingly, as the *Twelfth Annual Report* of IDB indicates, over a period of ten years (1977-1988) the amount of financing which the IDB advanced on a PLS basis was 7.33 million Islamic dinars which is 0.12 percent of its total financing over that period. The IDB's equity finance for that period amounted to five percent of its total financing, whereas the predetermined return-based types of financing like

[143] Homoud, "Ṣiyagh al-Tamwil al-Islāmi", p.43.
[144] Interview with 'Abd al-Qādir al-'Ush of JIB on 23.11.1989.
[145] DIB, *Annual Report: 1990*, p.5.
[146] BIB, *Annual Report* (1410 AH).
[147] Interviews with Ḥusain Kāmil of FIBE on 3.12.1989, and A. Nofal of FIBE on 4.12.1989.

trade financing, leasing and instalment sales amounted to 5,046 million Islamic dinars which represented eighty-five percent of its total financing.[148] If this is the situation of the Islamic Development Bank with regard to PLS financing, it is difficult not to conclude that other private sector Islamic banks which are basically profit-oriented entities would be less inclined to use PLS financing. Some interesting arguments have been put forward to explain the Islamic banks' neglect of PLS financing in favour of pre-determined return based types of financing: (i) Islamic banks do not regard themselves as development banks or investment banks, but commercial banks, and that development business is undertaken by state run banks to finance various projects; (ii) most Islamic banks are very young institutions, and their depositors expect competitive returns right from the beginning although projects of developmental importance and those in the manufacturing sector often have gestation periods of two, three or more years before they break-even; and (iii) it would be very risky to finance medium and long term projects out of short term funds.[149]

Problems related to the successful utilisation of PLS in the investment activities of Islamic banks. The two concepts, *muḍāraba* and *mushāraka*, (alternatively referred to in the literature as PLS), formed the theoretical basis of contemporary Islamic banking. Nevertheless, in practice, 'pure' PLS came to play a significantly less important role in investment operations. According to some observers of Islamic banking, this was due to many reasons, the most important of which are enumerated below.

Moral. It is claimed that low moral standards in many Muslim communities do not permit wide scale utilisation of PLS as an investment mechanism.[150] It is argued that the costs the bank will have to incur in monitoring would make banking operations both uneconomical and inefficient.[151] The Council of Islamic Ideology (CII) of Pakistan in its report on the islamisation of the Pakistani economy, said:

> For the profit/loss sharing system to be instituted properly it is necessary that all business enterprises obtaining capital from banks and other financial institutions should maintain proper accounts and that this should be done honestly so as to reveal the true working results of the enterprises. The actual position, however, is that most of the enterprises either do not maintain accounts or do not maintain them properly or keep different sets of accounts for different purposes. Even the accounts of the firms in the corporate sector, which are audited by chartered accountants, often fail to reveal their true working results because of the widespread malpractice of deflating profits, inflating losses and showing fictitious

[148] IDB, *Twelfth Annual Report*.
[149] Nienhaus, "The Potential Contribution of Islamic Banks".
[150] Homoud, "Ṣiyagh al-Tamwil al-Islāmi", p.43.
[151] Attia, "Financial Instruments Used by Islamic Banks", pp.101-19.

losses.[152]

For this reason, Islamic banks utilise PLS financing only after taking utmost care and only in those cases where the client is an efficient manager, is experienced in the area of business and straightforward in dealings and where the project is profitable and generally of a short term nature.

Inadequacy of PLS financing. PLS financing does not cater for many of the financing needs of contemporary economies. Although PLS in its *mushāraka* and *muḍāraba* forms is an excellent device by which to eliminate interest in personal dealings and short-term finance, its workability in the realm of institutional credit is severely hampered. The problems connected with its application render the two concepts of *mushāraka* and *muḍāraba*, at institutional credit level, 'virtually obsolete'.[153] Among the reasons are the increasing demands of governments for loans to finance budget deficits, or the demand for consumption loans for which PLS has no answer.[154]

Entrepreneurial. In terms of the banks' relations with borrowers, a PLS system clearly fosters more direct involvement than a traditional system. Banks would require more information about the business activities they financed and would be more likely to seek to influence the business decisions of clients. On the one hand, this heightened involvement might discourage entrepreneurs who sought maximum freedom of manoeuvre in the use of the funds they borrowed.[155] Shahrukh R. Khan who undertook research into the islamisation of the Pakistani banking system observed:

> The heavy supervising and monitoring rights allowed to the banks and the fear of disclosure that companies have may in any case restrict the use of this investment mode of finance from the entrepreneurial point of view.[156]

From a different perspective, in an environment of PLS financing, firms currently undergoing financial stress or suffering losses cannot get any finance.

Costs. Providing finance on a PLS basis requires constant vigilance by the banks over the utilisation of funds. Banks are likely to increase their staff by employing engineering and management experts to evaluate projects more thoroughly than under traditional lending techniques. This will result in increased costs that bankers will have to balance against prospective returns that could be earned by making more efficient use of funds.[157] These additional tasks which are required for the effective operation of Islamic banks may result in extra costs, which may in turn increase the cost of financing for PLS clients.

[152] CII, *Consolidated Recommendations*, p.9.
[153] Ahmad, *Towards Interest-Free Banking*, p.44.
[154] Ibid., p.45; Khan, "A Survey of Critical Literature on Interest-Free Banking", p.46.
[155] Karsten, "Islam and Financial Intermediation", pp.133-4.
[156] Khan, *Profit and Loss Sharing*, p.151.
[157] Karsten, "Islam and Financial Intermediation", pp.127-8.

Technical. Technical problems pertaining to PLS appear to be related to the bank, the client and profit calculation. On the part of the Islamic bank itself, professional staff at times are not adequately equipped with the information and expertise necessary for the operation of PLS. Under PLS, banks need knowledge of a range of economic activities and the normal profitability in each line on the one hand, and complete information about the investor's financial position and commitments on the other.[158] On the part of the clients, mass illiteracy in many parts of the Muslim world, such as Pakistan, would make the keeping of detailed accounts extremely difficult. The demand for detailed accounts is so onerous that people would rather forego bank finance than take the trouble of detailed bookkeeping.[159]

The calculation of profit in PLS ventures is also a difficult issue. Though there are some guidelines in *fiqh* on the calculation of profit, there does not seem to be any uniformity among Islamic banks on the method of the calculation of profit which, in accounting terminology, is a subjective concept. It varies with the valuation placed on assets and liabilities. The valuation in turn depends on such factors as the rate of depreciation of fixed assets, the policy of capitalisation of costs, the amortisation of fixed assets, and policy regarding reserves and provisions.[160] Thus the same business can show different profit figures without being accused of the falsification of accounts.

Unattractiveness of PLS financing to business. To businessmen and industrialists, the cost of funds under PLS is not accurately known. This is in addition to the exposure of their financial position to the bank as well as the bank's interference in their management affairs. This situation is at great variance with the interest-based system in which capital is secure, income is assured and the cost of borrowing is known.[161]

The issue of efficiency. Given an adequate supply of loanable funds, the level of investment may be higher under PLS because the entrepreneur can pass off part of the uncertainty of production to the lenders and because there are no competing financial assets diverting funds from real investment. The ability to pass risk on to the lender may well encourage the composition of investment towards the more risky. However, this ability may also reduce cost pressures for business efficiency which a fixed interest rate imposes.[162]

[158] Khan, "Islamisation of Banking in Pakistan", p.54.
[159] Carlson, "Legal Issues and Negotiations", pp.69-85.
[160] Edwards and Mellett, *Accountancy for Banking Students*, pp.73-122.
[161] Khan, *Profit and Loss Sharing*, pp.101-111.
[162] Ibid.

Concluding remarks

Muḍāraba as developed in the *fiqh* literature is a contract where a skilled person may utilise his skill with the money of the investor in order to realise a profit. It does not rest on any explicit *sharī'a* text but it has been practised from the earliest period of Islamic history. *Muḍāraba* as developed in *fiqh* was a contract where the *muḍārib* had the necessary freedom to conduct the *muḍāraba* in order to realise a profit. Since the *muḍārib* was the weaker party in the contract who, by definition, provided his skill as capital to the *muḍāraba*, the jurists did not allow the demanding of any guarantee from the *muḍārib*. Under Islamic banking, *muḍāraba* came to be used in commercial ventures of a very short term nature, where there is no transfer of funds to the *muḍārib*. There is no freedom to act, since all the minute details of how the *muḍāraba* should be managed are set out in the contract. The role of the *muḍārib* is restricted to enforcing the terms of the contract. By means of these terms, and by demanding various forms of guarantee, the bank is able to determine the outcome of the venture so as to ensure that it recovers its capital as well as return on that capital. The general concept of *muḍāraba*, that it is a form of venture capital financing or provision of credit to those who lack funds but have the skill to conduct trade or business on an uncertain return which may or may not be realised, does not appear to be prominent or significantly evident in the Islamic banking *muḍārabas*.

Mushāraka is justified on the basis of several texts of the *sharī'a* albeit rather arbitrarily. Islamic banks have utilised one form of *mushāraka*, that is *'inān* finance partnership. In *fiqh*, it appears that the *mushāraka* is utilised in a venture whose outcome is uncertain, that is, in the sense of a real business venture. In *fiqh*, the partner is given reasonable freedom to act in pursuit of profit. Since the partner is regarded as a trustworthy person, no guarantees are permitted. In profit sharing, the early jurists allowed the parties to share in the profits as agreed upon in the contract, though there was no agreement on the issue. In loss sharing there was no flexibility, as the jurists insisted that it should be according to the capital contribution ratio.

Under Islamic banking, although *mushāraka* is used in several forms, it is the commercial form which has become prominent, where the contract is closely related to the purchase and sale of certain specified goods. The commercial *mushāraka* enables the bank to recover its capital, plus return, without much uncertainty. The partner is restricted in his actions by the detailed terms of the contract which do not leave much freedom to the partner to conduct a *mushāraka* in the real sense of the term as it was developed in *fiqh*. From the terms of the contracts of Islamic banks, it appears that the partner is more like an agent of the bank where the agent's function is to sell the goods involved at the price specified by the bank in order to realise

the return the bank is aiming at. The bank's share of capital and its return thereon is well protected by various forms of guarantees and terms of the contract. The partner also appears to be a symbolic figure who has no say in setting out the *mushāraka* contracts, since it is the bank that dictates the *mushāraka* terms.

It is important to note that the utilisation of these two concepts purely as PLS is extremely limited in Islamic banking, allowing little optimism regarding its wider use.

CHAPTER FIVE

MURĀBAḤA FINANCING MECHANISM

Islamic banking theorists argue that Islamic banking should be based on Profit and Loss Sharing (PLS) rather than interest. Islamic banks in practice, however, have found from the very beginning that PLS-based banking is difficult to implement as it is risk-laden and uncertain. The practical problems associated with this financing have led to its gradual decline in Islamic banking, and to a steady increase in the utilisation of 'interest-like' financing mechanisms. One such mechanism is termed *'murābaḥa'*. This chapter investigates *murābaḥa,* the most important investment mechanism in Islamic banking today. It identifies the nature of the *murābaḥa* contract and its application in Islamic banking, and compares *murābaḥa* financing with fixed interest based financing in several key areas.

Murābaḥa in fiqh

There are three parties, *A*, *B* and *C,* in a *murābaḥa* sale. *A* requests *B* to buy some goods for *A*. *B* does not have the goods but promises to buy them from a third party, *C*. *B* is a middleman, and the *murābaḥa* contract is between *A* and *B*. This *murābaḥa* contract is defined as a "sale of a commodity at the price which the seller (*B*) paid for it originally, plus a profit margin known to the seller (*B*) and the buyer (*A*)."[1] Since its inception in Islamic law, the contract of *murābaḥa* appears to have been utilised purely for commercial purposes. Udovitch suggests that *murābaḥa* is a form of commission sale, where a buyer who is usually unable to obtain the commodity he requires except through a middleman, or is not interested in the difficulties of obtaining it by himself, seeks the services of that middleman.[2]

The Qur'ān, however, does not make any direct reference to *murābaḥa,* though there are several references therein to sale, profit, loss, and trade. Similarly, there is apparently no *ḥadīth* which has a direct reference to *murābaḥa*. Early scholars like Mālik and Shāfi'i who specifically said that a *murābaḥa* sale was lawful, did not support their view with any *ḥadīth*. Al-Kaff, a contemporary critic of *murābaḥa*, concluded that *murābaḥa* was "one of those sales which were not known during the era of the Prophet or his Companions."[3] According to him, prominent scholars began to express

[1] Jazīri, *Fiqh*, II, pp.278-80.
[2] Udovitch, *Partnership and Profit*, p.221.
[3] al-Kaff, *Does Islam Assign Any Value*, p.8.

their views on *murābaḥa* in the first quarter of the second century AH, or even later.[4] Since there is apparently no direct reference to it either in the Qur'ān or in the generally accepted sound *ḥadīth*, jurists had to justify *murābaḥa* on other grounds. Mālik supported its validity by reference to the practice of the people of Medina:

> There is consensus of opinion here [in Medina] on the lawfulness of a person's purchasing cloth in a town, and taking it to another town for selling it on the basis of an agreed upon profit.[5]

Shāfi'i, without justifying his view by any *sharī'a* text, said:

> If a person shows a commodity to a person and says, 'Purchase it for me, and I will give you such and such profit,' and the person purchases it, the transaction is lawful.[6]

The Ḥanafi jurist, Marghīnāni (d.593/1197), justified it on the ground that "the conditions essential to the validity of a sale exist in it, and also because mankind stands in need of it."[7] The Shāfi'i jurist, Nawawi (d.676/1277) simply said: "*Murābaḥa* sale is lawful without any repugnance."[8]

Murābaḥa in Islamic banking

Islamic banks have adopted *murābaḥa* to provide mainly short term finance to clients to purchase goods even though the client may not have the cash to pay. *Murābaḥa*, as utilised under Islamic banking, is founded essentially on two basic elements: the purchase price and related costs, and an agreed upon mark-up (profit).[9] The basic features of a *murābaḥa* contract (as a deferred payment sale) are the following: (i) that the buyer should have knowledge of all related costs and the original price of the commodity, and the profit margin (mark-up) should be defined as a percentage of the total price plus costs; (ii) that the subject of the sale should be goods or commodities against money; (iii) that the subject of sale should be in the possession of the seller and owned by him and he should be capable of delivering it to the buyer; and (iv) that payment is deferred.[10] *Murābaḥa*, as conceived here, is utilised in any financing where there is an identifiable commodity to be sold.[11]

Islamic banks in general have been using *murābaḥa* as their major method of financing, constituting approximately seventy-five percent of

[4] Ibid.
[5] Ibid., pp.5-6.
[6] Shāfi'i, *Umm*, III, p.33.
[7] Marghināni, *Hedaya, or Guide*, p.282.
[8] Nawawi, *Rawḍat al-Ṭālibin*, p.526.
[9] Saleh, *Unlawful Gain*, p.94.
[10] Moḥammed, "Islamic Banks' Practices in *Murābaḥa*" pp.3-4.
[11] Khan, A.J. "Divine Banking System", pp.39-40; CII, *Consolidated Recommendations*, p.15.

their assets.[12] This percentage is roughly true for many Islamic banks as well as Islamic banking systems in Pakistan and Iran. As early as 1984, in Pakistan, *murābaḥa*-type financing amounted to approximately eighty-seven percent of total financing in the investment of PLS deposits.[13] In the case of the Dubai Islamic Bank (DIB), the earliest private sector Islamic bank, *murābaḥa* financing amounted to eighty-two percent of the total financing for the year 1989.[14] Even for the Islamic Development Bank (IDB), over a ten year period of financing, seventy-three percent of its total financing was on a *murābaḥa* basis, that is in its foreign trade financing.[15]

Several reasons are given for the popularity of *murābaḥa* in Islamic banking investment operations: (i) *murābaḥa* is a short-term investment mechanism, and, compared with Profit and Loss Sharing (PLS), is convenient; (ii) mark-up in *murābaḥa* can be fixed in a manner which ensures that the banks are able to earn a return comparable to that of interest-based banks with which the Islamic banks are in competition; (iii) *murābaḥa* avoids the uncertainty attached to earnings of businesses under a system of PLS;[16] and (iv) it does not allow the Islamic bank to interfere with the management of the business since the bank is not a partner with the client but their relationship instead, under *murābaḥa*, is that of a creditor and a debtor respectively.

Higher credit price in murābaḥa

Murābaḥa, as a deferred payment sale, can be either (i) against the cash price, avoiding any mark-up in lieu of time allowed for the payment, or (ii) against the cash price plus a mark-up in lieu of time allowed for the payment.[17] The focus of this chapter is on the second form of deferred payment sale.

Jurists do not question the lawfulness of the first form of deferred payment sale, that is, against cash price. Difference of opinion exists among jurists on the lawfulness of a higher credit price (as opposed to a cash price) in a deferred payment sale.[18] Prominent early jurists such as Mālik and Shāfi'i did not sanction a higher price for deferred payment and a lower price for cash payment. Neither in the *Muwaṭṭa'* of Mālik nor in Shāfi'i's discussion of deferred payment sales in *Kitāb al-Umm*, was the present writer able to locate any view of these jurists in which they allowed the sale of a commodity on a *murābaḥa* basis with the credit price being higher than the cash price.[19]

[12] al-Tamimi, "Experience of Islamic Banks in the Middle East", p.33.
[13] Khan, *Profit and Loss Sharing*, p.145.
[14] Dubai Islamic Bank, *Annual Report*, 1989.
[15] Islamic Development Bank, *Twelfth Annual Report*.
[16] Ahmad, *The Present State of Islamic Finance Movement*, p.24.
[17] IAIB, *100 Questions and 100 Answers*, p.385.
[18] Miṣri, *Maṣraf al-Tanmiyat al-Islāmi*, p.185.
[19] Shāfi'i, *Umm*, III, pp.31-5.

Though these early scholars did not sanction a higher price for deferred payment sales, the Ḥanafis, Shāfi'is, and many jurists of other schools of law held the view that the increase in deferred payment sale was lawful.[20] According to the Ḥanbali scholar Ibn Qayyim, "when someone sells something for one hundred on deferred payment basis, or for fifty on cash payment basis, there is no *riba* in it."[21] Baghawi (d.516/1122)[22] claims that there is no difference of opinion on a *murābaḥa* sale on condition that the buyer and seller agree on one price (of the two prices, that is, cash price and credit price). This is, reportedly, the view of Ṭāwūs (d.106/725).[23] This view implies that charging a higher price in a deferred payment sale is prohibited only if the seller says to the buyer, 'I will sell this for so and so for cash, and for so and so for credit.'[24] If the seller from the outset says that he will sell it for so and so for credit, and does not mention anything related to cash price, there would not be any problem of unlawfulness.[25] Many jurists, including Sarakhsi (d.483/1090), Marghīnāni, Ibn Qudāma and Nawawi categorically stated that charging a higher price for a credit sale is the customary practice of merchants, and on this basis, the jurists have permitted the higher price.

In the context of Islamic banking, several arguments have been advanced to support the lawfulness of a higher price in a deferred payment sale: (i) that the *sharī'a* texts do not prohibit it; (ii) that there is a difference between cash available now and cash available in the future as according to 'Ali al-Khafīf, a contemporary jurist, "the custom (*'urf*) is that cash given immediately is higher in value than cash given in the future"; (iii) that this increase is not against time allowed for payment, and hence, does not resemble pre-Islamic *riba* prohibited in the Qur'ān; (iv) that the increase is charged at the time of the sale, not after the sale occurred; (v) that the increase is due to factors influencing the market such as demand and supply, and the rise or fall in the purchasing power of money as a result of inflation or deflation;[26] (vi) that the seller is engaged in a 'productive' and recognised commercial activity. Rafīq al-Miṣri, a contemporary Islamic banking theorist and a proponent of this view, while conceding that the increase represents interest on the loan, says: "In a deferred payment sale, it is not possible to equate the seller with the usurer, even though the deferred payment sale in reality consists of a cash sale and a loan with interest. However, the seller himself combines these two activities in one activity, that is 'sale'. The seller in

[20] Shawkāni, *Nayl al-Awṭār*, V, p.152.
[21] Shiḥāta, *Naẓariyyat al-Muḥāsaba*, p.104.
[22] Baghawi, *Sharḥ al-Sunna*, VIII, p.143.
[23] Ibn Qudāma, *Mughni*, IV, p.211; Abu Dā'ūd al-Ṭayālisi, *Musnad*, III, pp 739-40; Tirmidhi, *Sunan*, III, Part 3, p.533.
[24] Shawkāni, *Nayl al-Awṭār*, V, p.153.
[25] Ibid.
[26] Shiḥāta, *Naẓariyyat al-Muḥāsaba*, pp.104-7; KFH, *A Collection of Booklets*.

this case practises at least a commercial activity which is productive and recognised as lawful."[27]; (vii) that the seller is allowed to charge whatever price he may wish. Rafiq al-Miṣri says:

> The seller, as a matter of principle, is free to determine prices for his goods. If these prices are very high, either the buyers would refuse to buy the goods or search for substitutes, or other sellers would enter the market to bring equilibrium to it.[28]

The above arguments have been brought forward by the Islamic banks to justify the increase in the deferred payment sale which is positively related to the length of time of the debt. Islamic banks as a matter of course have accepted the lawfulness of this increase, and it has become standard practice to charge a higher price in deferred payment sales as long as the transaction *explicitly* does not involve exchanging money for money.

The increase in credit price in murābaḥa

Many prominent early jurists seem to have refused to recognise that any increase in a loan or sale price can be justified on the basis of time, because time itself is not money or a material object that could be a countervalue in a loan. The Ḥanafi jurist Jaṣṣāṣ[29] states that expediting payment of a loan on condition that the creditor reduces the amount is *riba*, basing his view on a report of Zayd b. Thābit (d.45/665), 'Abd Allah b. 'Umar (d.73/693), Sa'īd b. Jubayr (d.95/714) and al-Sha'bi (d.103/722).[30] These early scholars equated a reduction in lieu of time in a loan/debt, with *riba*. Zayd b. Thābit judged that a gain from such a reduction should not be used by the receiver, nor should he give it to others.[31]

Abu Ḥanīfa reportedly refused to recognise the validity of a contract in which a person says to his tailor: 'If you tailor it today you would get one dirham, and if you tailor it tomorrow you would get half a dirham.' According to Jaṣṣāṣ, "the second condition is null and void. If he tailors the next day he shall get a similar rate (one dirham) because the cloth owner made the reduction against time while the work is one in both times."[32] In a sales transaction the Ḥanafi jurist Shaybāni (d.189/855), for example, did not approve selling at a lower price in cash in contradistinction to a higher price on credit. In the context of explaining the unlawfulness of making an earlier payment by the debtor against a reduction of the amount payable, Shaybāni's view was that it is not good for the borrower because he expedites a lesser amount in cash against a larger amount on credit, or if he is

27 Miṣri, *Maṣraf al-Tanmiyat al-Islāmi*, p.189.
28 Ibid., p.187.
29 Jaṣṣāṣ, *Aḥkām al-Qur'ān*, I, p.467.
30 Ibid., pp.467-68.
31 Mālik b. Anas, *Muwaṭṭa'*, p.271.
32 Jaṣṣāṣ, *Aḥkām al-Qur'ān*, I, p.467.

selling at a lower price in cash against a higher price on credit.[33] Rāzi, in his commentary on *riba* verses, rejected the notion that 'time allowed for payment' can be a countervalue for an increase, because "it is not goods or a thing which could be pointed at, to make it a countervalue."[34]

This discussion indicates that many early authorities considered that a value cannot be assigned to time and as a result an increase cannot be demanded from the debtor on the basis of an extension given for payment. In the modern period, critics of *murābaḥa* like al-Kaff[35] maintain that the increase against time would be *riba*. The Council of Islamic Ideology of Pakistan (CII) states that doubts might arise in relation to the increase the seller is receiving in the case of deferred payment sales (that it is against the time given to the buyer for payment), and, therefore, such increase may resemble *riba*.[36]

However, Islamic banks and those who endorse the utilisation of *murābaḥa* in Islamic banking like Mohammed (1989), Saleh (1986), Ṭā'il (1988), the International Association of Islamic Banks (IAIB), Shiḥāta (1987) and al-Miṣri (1977) do not regard the increase in credit price as having any similarity to *riba*. In the contemporary financial environment, these scholars apparently consider that *riba* is something which occurs primarily in a loan, that is, in an exchange of money for money. They contend that in a loan, any contractual obligation to pay an increase is *riba*, regarding such an increase as against time given for payment of the loan. Shiḥāta says: "Islam prohibits any increase over and above the principal in a loan."[37]

Perhaps sensing that there is some similarity between an increase in *murābaḥa* and an increase given to the creditor against an extension of the maturity of a debt, (which in some ways is similar to *riba* as prohibited in the Qur'ān) some scholars have attempted to avoid any link between the increase in *murābaḥa*, and the time allowed for payment. According to Shiḥāta, the increase is not "against extension given for payment."[38] If this is the case, then the existence of a lower price for immediate payment, and a higher price for deferred payment is unnecessary. A rather strange view is that of the Kuwait Finance House (KFH). According to the KFH, the increase in *murābaḥa* is not against time, but against the goods themselves![39]

The view that the increase in deferred payment sales is against the goods is untenable. If it were against the goods sold, the existence of two prices, a cash price and a higher credit price, would be meaningless. The goods are

33 Mālik b. Anas, *Muwaṭṭa'*, p.271.
34 Rāzi, *Tafsīr*, VII, p.97.
35 al-Kaff, *Does Islam Assign Any Value*, pp.12ff.
36 CII, *Consolidated Recommendations*, p.36.
37 Shiḥāta, *Naẓariyyat al-Muḥāsaba*, p.107.
38 Ibid.
39 KFH, *A Collection of Booklets*, p.42.

one in both cases, and therefore, any price should be one as well. The cash price reflects the cost plus profit margin, whereas the credit price reflects cost plus profit margin plus an allowance against credit period allowed (time). Supporting this line of thinking, several scholars have clearly stated that the increase in deferred payment is against time given for payment. Siddiqi, a leading proponent of Islamic banking, says: "The mark-up would tend to be higher the longer the period of time involved."[40] The Saudi Arabian scholar, Ibn Bāz,[41] in a legal opinion (*fatwa*) and Rafīq al-Miṣri,[42] in his discussion of deferred payment sales, established the same link. Al-Miṣri stated that the payment in deferred payment sales in which an increase was added for the sake of delay in payment involved a loan with interest. According to him, "the deferred payment sale consists of two elements: a cash sale plus a loan at interest. This interest represents the difference between cash price and deferred payment price."[43] Tadamon Islamic Bank's Religious Supervisory Board (RSB) also acknowledges frankly that the increase is against time but says it is permissible. Based on Shāfi'i's view on the lawfulness of *al-'ina* sale, and on the interpretation of the 'two sales in one sale' *ḥadīth*, the RSB concluded: "The increase in price in lieu of time is lawful and valid." Further on, the RSB said: "It is lawful in the *shari'a* that part of the price can be given in lieu of time in a financial transaction."[44] This appears to be the view of all Islamic banks whose *murābaḥa* contracts are being studied here.

Comparison between financing on the basis of murābaḥa and fixed interest

The aim of this brief comparison is to see whether there is a significant difference between financing on the basis of *murābaḥa* and fixed interest for similar purposes. The comparison focuses on the following aspects: cost of financing; risks in *murābaḥa* financing; security; the relationship between the bank and the buyer; and settlement of the debt.

Cost of financing. Islamic banks claim that when the traditional bank lends money, for instance to purchase certain goods, interest charged on the loan is related to the principal and the maturity of the loan. They emphasise also that if the loan is for such a purpose it is not of concern to the traditional bank what the cost of the goods may be for its client. Rather, according to the Islamic banks, the main concern of the traditional bank is to obtain the currently prevailing interest rate for similar advances in terms of risk and maturity.[45] It is the client's responsibility, after obtaining the loan

[40] Siddiqi, *Issues in Islamic Banking*, p.138.
[41] KFH, *al-Fatāwa al-Shar'iyya*, I, pp.97-8.
[42] Miṣri, *Maṣraf al-Tanmiyat al-Islāmi*, pp.195ff.
[43] Ibid., p.188.
[44] TIB, *al-Tājir al-Ṣadūq*, p.28.
[45] Moḥammed, "Islamic Banks' Practices in Murābaḥa", pp. 10-2.

at a given interest rate, to buy the goods he needs whatever their cost may be. The argument is that the Islamic bank's *murābaḥa* method ensures that the client would know *beforehand* the total cost of the goods. This, it is argued, would not be known under interest-based financing since the interest charged is on the advances the bank makes to the client whether that advance covers the total cost of the goods or not. Secondly the interest rate could be fixed or variable. In the latter case it would be more difficult for the client to arrive at the total cost.

It is true that under traditional bank lending, the interest rate charged on advances can be either fixed or variable. Fixed interest rates, once agreed between the lending bank and the client, do not change throughout the loan period. Variable interest rates on loans change at particular intervals agreed upon between the bank and the client, in order to adjust the interest rate to the market interest rates prevailing at the time of review. Whether the interest rate is fixed or variable is perhaps unimportant in the very short term, since large changes in interest rates do not generally occur in the very short term. This is noteworthy since *murābaḥa* contracts are generally of a short term nature. In the case of interest, the rate charged would depend on the bank's need to earn a real return as well as inflation, uncertainty about future rates of inflation, liquidity preference and the demand for borrowing, monetary policy, and even interest rates abroad.[46] In *murābaḥa*, factors that appear to influence the mark-up rate are the Islamic bank's need for a real return, inflation, prevailing interest rates, monetary policy, and even interest rates abroad, together with the marketability of the *murābaḥa* goods involved, and the expected profit rate from those goods.[47] This means that, broadly speaking, many factors influencing interest rates are those which affect the mark-up in *murābaḥa*. The consequence of this similarity between factors would be that interest rate and mark-up in *murābaḥa* on comparable advances would be quite similar. Ḥusain Kāmil of the Faisal Islamic Bank of Egypt (FIBE) acknowledged this similarity between *murābaḥa* mark-ups and interest rates. According to him, the mark-up could be slightly higher or lower than the prevailing interest rate, but the difference between *murābaḥa* mark-up and prevailing interest rate for similar advances would not generally be large.[48] To a question directed to him, on the method of profit calculation in *murābaḥa*, The Chief Executive of the Qatar Islamic Bank replied:

> Rates of interest are taken into account when the mark-up on *murābaḥa* transactions is determined. This is being practical and facing the facts of life. Inflation is measured, and rates of interest and inflation are com-

[46] BPP, *Monetary Economics*, p.188.
[47] IIBID, *Bay' al-Murābaḥa*, pp.17-8; interviews with 'Abd al-Qādir al-'Ush (Jordon Islamic Bank) on 23.11.1989, Ḥusain Kāmil (Faisal Islamic Bank of Egypt) on 3.12.1989, and Gharīb Nāṣer (International Islamic Bank for Investment and Development) on 6.12.1989.
[48] Interview on 3.12.1989.

one in both cases, and therefore, any price should be one as well. The cash price reflects the cost plus profit margin, whereas the credit price reflects cost plus profit margin plus an allowance against credit period allowed (time). Supporting this line of thinking, several scholars have clearly stated that the increase in deferred payment is against time given for payment. Siddiqi, a leading proponent of Islamic banking, says: "The mark-up would tend to be higher the longer the period of time involved."[40] The Saudi Arabian scholar, Ibn Bāz,[41] in a legal opinion (*fatwa*) and Rafiq al-Miṣri,[42] in his discussion of deferred payment sales, established the same link. Al-Miṣri stated that the payment in deferred payment sales in which an increase was added for the sake of delay in payment involved a loan with interest. According to him, "the deferred payment sale consists of two elements: a cash sale plus a loan at interest. This interest represents the difference between cash price and deferred payment price."[43] Tadamon Islamic Bank's Religious Supervisory Board (RSB) also acknowledges frankly that the increase is against time but says it is permissible. Based on Shāfi'i's view on the lawfulness of *al-'ina* sale, and on the interpretation of the 'two sales in one sale' *ḥadīth*, the RSB concluded: "The increase in price in lieu of time is lawful and valid." Further on, the RSB said: "It is lawful in the *sharī'a* that part of the price can be given in lieu of time in a financial transaction."[44] This appears to be the view of all Islamic banks whose *murābaḥa* contracts are being studied here.

Comparison between financing on the basis of murābaḥa and fixed interest

The aim of this brief comparison is to see whether there is a significant difference between financing on the basis of *murābaḥa* and fixed interest for similar purposes. The comparison focuses on the following aspects: cost of financing; risks in *murābaḥa* financing; security; the relationship between the bank and the buyer; and settlement of the debt.

Cost of financing. Islamic banks claim that when the traditional bank lends money, for instance to purchase certain goods, interest charged on the loan is related to the principal and the maturity of the loan. They emphasise also that if the loan is for such a purpose it is not of concern to the traditional bank what the cost of the goods may be for its client. Rather, according to the Islamic banks, the main concern of the traditional bank is to obtain the currently prevailing interest rate for similar advances in terms of risk and maturity.[45] It is the client's responsibility, after obtaining the loan

[40] Siddiqi, *Issues in Islamic Banking*, p.138.
[41] KFH, *al-Fatāwa al-Shar'iyya*, I, pp.97-8.
[42] Miṣri, *Maṣraf al-Tanmiyat al-Islāmi*, pp.195ff.
[43] Ibid., p.188.
[44] TIB, *al-Tājir al-Ṣadūq*, p.28.
[45] Moḥammed, "Islamic Banks' Practices in Murābaḥa", pp. 10-2.

at a given interest rate, to buy the goods he needs whatever their cost may be. The argument is that the Islamic bank's *murābaḥa* method ensures that the client would know *beforehand* the total cost of the goods. This, it is argued, would not be known under interest-based financing since the interest charged is on the advances the bank makes to the client whether that advance covers the total cost of the goods or not. Secondly the interest rate could be fixed or variable. In the latter case it would be more difficult for the client to arrive at the total cost.

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[46] BPP, *Monetary Economics*, p.188.
[47] IIBID, *Bay' al-Murābaḥa*, pp.17-8; interviews with 'Abd al-Qādir al-'Ush (Jordon Islamic Bank) on 23.11.1989, Ḥusain Kāmil (Faisal Islamic Bank of Egypt) on 3.12.1989, and Gharib Nāṣer (International Islamic Bank for Investment and Development) on 6.12.1989.
[48] Interview on 3.12.1989.

> pared to each other. We look at mark-ups and returns on the money that we invest in the underlying transactions, as we have to satisfy the profitability considerations of both the depositors and the shareholders.[49]

Some proponents of Islamic banking argue that the *murābaḥa* mark-up would be lower than the current prevailing interest rate for similar advances. The reason given is that the Islamic bank, because of its ability to purchase goods in bulk, would be able to obtain discounts from suppliers. These discounts could then be transferred to the *murābaḥa* clients in the form of lower mark-ups, which would lower the clients' cost of financing. While the argument may be theoretically plausible, the present writer was unable to obtain any data to substantiate the claim. However, the manner in which Islamic banks practise *murābaḥa* does not lend much support to this view. They generally purchase goods when each client makes his purchase request, indicating that each purchase is independent of other purchases. Unless the Islamic bank has a trading subsidiary which buys in bulk, the cost of goods through an Islamic bank's *murābaḥa* finance may not be lower. However, given the competition between the Islamic and traditional banks in advancing finance, the need to provide a comparable return to the depositors and shareholders of the Islamic bank, and the close rates of mark-up and interest, such a transfer to the *murābaḥa* clients, even if it existed, is unlikely to be large. It can be argued that instead of being lower, the cost of financing on a *murābaḥa* basis could be higher. In interest-based financing, the banker is provided with the relevant financial data to assess the financial position of the client, and the project for which financing is required. The costly market research, the paperwork involved in processing the *murābaḥa* financing requests, contact with suppliers, handling of the documents, constant monitoring of the progress of *murābaḥa* goods sale even after delivery to the client, all require more involvement of bank personnel, compared to fixed interest financing. The increase in costs would be reflected in the total cost of *murābaḥa* goods.

Murābaḥa: risk free or risk sharing? Finance on the basis of risk-sharing with which the theoretical model of Islamic banking is identified[50] does not seem to be a dominant characteristic of the *murābaḥa* operations of Islamic banks. Despite this, it is argued by some proponents of Islamic banking that even in *murābaḥa*, the risk-sharing factor exists, which justifies the return. According to Abdeen and Shook, "the bank takes a risk, which justifies the profit, until the client fulfils his original promise to purchase the commodity."[51] The following is a brief discussion of the risks related to (i) the goods, (ii) the client, and (iii) the payment.

Risks related to the goods. The Islamic bank purchases goods requested

[49] Quasim, "Islamic Banking: New Opportunities for Cooperation", p.25.
[50] Siddiqi, *Banking Without Interest;* Uzair, *Interest-Free Banking.*
[51] Abdeen and Shook, *The Saudi Financial System*, p.189.

by its *murābaḥa* client, and *theoretically* bears the risk of loss or damage to the goods from the time of purchase to the time of delivery to the client. The bank is obliged under the *murābaḥa* contract to deliver them to the client in good condition. According to Islamic law, the client is entitled to reject goods which are damaged, deficient in quantity, or do not meet his specifications. In the case of *murābaḥa* which is related to domestic trade, these risks may be less significant, whereas in international trade, the significance of such risks should not be overlooked.

The Islamic bank, however, in practice avoids these risks by means of insurance and contract terms. Insurance is a cost which the *murābaḥa* client has to bear, as it is a cost added to the *murābaḥa* expenses in arriving at the total cost of the goods.[52] The contract terms are phrased in a way which helps the Islamic bank avoid any risk related to goods. For instance, with regard to the specifications of the items, the risk is avoided by placing the responsibility for stating the correct specifications onto the client in the *murābaḥa* purchase request. The client, in many cases, has to provide, in addition to the specifications, even the suppliers' names.[53] Confirming the risk-avoiding behaviour of Islamic banks, the contract of *murābaḥa* of FIBE, for instance, states that the client:

> affirms that he has examined the goods relating to this contract well, in a way which would negate the existence of any uncertainty (*jahāla*), and that he accepts the goods in their present condition, and that he does not have any right to have recourse to the seller (the bank) for any reason whatsoever.[54]

It must be noted that the contract of *murābaḥa* is signed generally *before* the Islamic bank 'acquires' the goods requested by the client (that is, before the arrival of goods at the port or the bank's warehouse). According to the contract, it is the client who should be aware of and follow the laws and regulations relating to the importation of goods, profit ratios and correct specifications. The client "alone undertakes any responsibility for fines or punishments resulting from the contravention of them."[55] In short, the bank is not willing to take responsibility in relation to the goods. Therefore, any risk relating thereto, which the bank theoretically has to bear, is effectively avoided.

Risks related to the client. The promise of the client to purchase the requested goods is not binding in a *murābaḥa* transaction, according to the majority of jurists of Islamic law.[56] Hence, the client has the right to refuse purchase of the goods when the Islamic bank offers them for sale. In their

[52] JIB, Jordan Islamic Bank, *'Aqd Bay' al-Murābaḥa;* FIBE, *'Aqd Bay' al-Murābaḥa.*
[53] FIBE, *'Aqd Bay' al-Murābaḥa.*
[54] Ibid.
[55] Ibid.
[56] Shāfi'i, *Umm*, III, pp.33ff; Marghīnāni, *Hedaya, or Guide,* pp.282ff.

defence of *murābaḥa*, Islamic banks tend to justify the return on their *murābaḥa* operations, most importantly, on the basis of this business risk involved in the operation. Nabil Saleh says:

> This business risk is identified with the fact that the purchaser in a *murābaḥa* transaction is not compelled... to buy the commodity he has ordered, but can always change his mind when the time comes for taking possession of the ordered commodity even though it satisfies all the requirements and standards he has asked for.[57]

The risk to the bank that the client may renege on the purchase of the commodity is avoided by means of advance payment (one-third of the total cost, for instance), security, third party guarantees, and terms of the contract.[58] The advance payment would be sufficient to cover any loss which may eventuate from the disposal of goods by the bank, as a result of such a refusal by the client. If the bank is not satisfied as to the adequacy of the advance payment, it may require securities and third party guarantees to cover the amount of the *murābaḥa* or part of it. This is to ensure the client's fulfilment of the terms of the contract, and also to recover the cost of the goods and the profit agreed upon in the contract. The contract of *murābaḥa* of FIBE states:

> It is agreed upon between the two parties that in case the second party [the *murābaḥa* client] refuses to take delivery of the documents, the bank has a right to sell the goods at the prevailing price in the market on behalf of the second party, and receive the price as a compensation for what was due to the bank. If that price was insufficient, the bank has a right to demand from the client the balance [of what is due to the bank, according to the *murābaḥa* contract, including the profit margin], without any objection from the client.[59]

Moreover, Islamic banks, with the support of their Religious Supervisory Boards (RSBs), have been treating the promise to buy in a *murābaḥa* request as binding. In the fifth session of the Islamic Fiqh Academy held in Kuwait, the participants adopted the view that such a promise is binding unless there is a reasonable and acceptable excuse. The Islamic Banking Conference held in Dubai (1979), in one of its recommendations said:

> This dealing [*murābaḥa*] involves a promise by the client of the bank that he will purchase the goods as stipulated, and another promise by the bank that it will conclude the sale contract with the client, after purchasing the goods as stipulated. Such a promise is legally binding on both parties according to the rules of the Māliki school, and religiously binding according to other schools. What is binding religiously can be made binding legally if it is in the interest [of the parties concerned].[60]

[57] Saleh, *Unlawful Gain*, p.89.
[58] FIBE, *'Aqd Bay' al-Murābaḥa*; JIB, *'Aqd Bay' al-Murābaḥa;* Moḥammed, "Islamic Banks' Practices in Murābaḥa".
[59] FIBE, *'Aqd Bay' al-Murābaḥa*.

This attitude towards the promise to purchase the goods in *murābaḥa* has systematically eliminated the option given to the *murābaḥa* client in Islamic law to buy or not to buy the goods requested from the seller. Any risk which theoretically may have existed in relation to the client's refusal to buy the goods is virtually eliminated in Islamic banking practice.

Risks related to the payment. A risk of non-payment of full or part of the advance, as scheduled in the contract, exists in a *murābaḥa* financing. The Islamic bank avoids this risk by means of promissory notes, security, third party guarantees, and a term of the contract stating that all proceeds of *murābaḥa* goods which are sold to third parties [either on cash or credit] should be deposited with the bank until what is due to the bank is repaid in full.[61] If the non-payment is due to factors over which the client has no control, the Islamic bank is morally under obligation to reschedule the debt. On the other hand, if the client has the ability to pay on time, but does not, then the banks and their RSBs have adopted the concept of a 'fine' to be imposed on the client. The amount of the 'fine' would depend on 'normal rate of return' on the bank's funds invested, which is the opportunity cost of the capital.[62] In some cases where the recovery of the advance is not possible, the Islamic bank may realise the security to recover the advance.

As stated above, in practice, Islamic banks effectively eliminate these risks in their *murābaḥa* operations. *Murābaḥa*, which is the dominant method of investment of funds in Islamic banking is, for all practical purposes, a virtually risk-free mode of investment, providing the bank with a predetermined return on its capital. As the Council of Islamic Ideology Report recognises, in *murābaḥa* there is "the possibility of some profit for the banks without the risk of having to share in the possible losses, except in the case of bankruptcy or default on the part of the buyer."[63]

Security. Taking security for a debt is not in itself reprehensible, according to the Qur'ān or the *sunna*. The Qur'ān commands Muslims to write their obligations, and, if necessary, to take security for the debt.[64] The Prophet on several occasions provided his creditors with security for his debts. Security is a method of ensuring that rights of creditors are not forfeited, and of avoiding "eating people's property without their consent."[65] However, since demanding security is seen by some Islamic banking proponents as an obstacle to the flow of bank finance to relatively low income en-

[60] KFH, *A Collection of Booklets*, p.68.
[61] FIBE, *'Aqd Bay' al-Murābaḥa*; IIBID, *Bay' al-Murābaḥa*; Banque Misr, *'Aqd Bay' al-Murābaḥa* ; JIB, *'Aqd Bay' al-Murābaḥa*.
[62] Moḥammed, "Islamic Banks' Practices in Murābaḥa", pp.16-17.
[63] CII, *Consolidated Recommendations*, p.15.
[64] Qur'ān 2:283.
[65] Qur'ān 2:188; 4:161; 9:34.

trepreneurs,[66] Islamic banks tend to criticise the traditional banks as too 'security oriented'. In the words of the International Islamic Bank for Investment and Development (IIBID), the securities are 'the most important element' in a lending decision of a traditional bank.[67] This implies that for the Islamic bank, security is not an important issue in its financing decisions.

In the context of traditional bank lending, security plays the important role of ensuring the repayment of loans when they are due. However, security is not the most important factor in determining whether an advance should or should not be made to a client. Pitcher, a traditional banker, says:

> Most of us learn during our training that this [security] is one of the less important aspects of a lending proposition, but to many of our customers it often appears to be an overriding factor in the forefront of our minds when we view their request and a prerequisite for any meaningful discussion. I can well remember an old manager telling me soon after I joined the bank, 'Don't let security influence a lending decision; I never lend money with security that I wouldn't lend without'... Lending against tangible security has its place, but to concentrate on it exclusively must restrict unfairly the flow of bank finance to soundly controlled enterprises which could borrow funds successfully if only they possessed the necessary asset backing to pledge as collateral.[68]

The *murābaḥa* contracts of Islamic banks and the Islamic branches of traditional banks contain terms which emphasise the significance of security. In the contracts of the Faisal Islamic Bank of Egypt (FIBE), the Jordan Islamic Bank (JIB), the International Islamic Bank of Investment and Development (IIBID), the Egyptian Gulf Bank (EGB), the Bank of Credit and Commerce (BCCI) and the Banque Misr, for instance, guarantees and securities are demanded from clients. These securities could be in the form of immoveable and moveable property, the *murābaḥa* goods themselves where they are suitable for security, third party guarantees, advance payments, and commercial paper. According to the contract, the bank has the right to demand from the client any additional guarantee (security) which is acceptable to the bank in case it thinks that the guarantees already provided are insufficient. If demanded, the client must provide them without any objection or delay.[69] Generally, the third party guarantee is absolute. The JIB *murābaḥa* contract, for instance, says:

> The third party provides an absolute guarantee for the client's liabilities and obligations arising from this contract. The third party agrees that his guarantee is an additional guarantee. It cannot influence or be influenced by any other guarantees which may have been given already by the client, or which the bank may obtain from him in future. The third party considers himself bound by this guarantee as a continuous insurance.[70]

[66] Najjār, *Bunūk bila Fawā'id.*
[67] IIBID, *Bay' al-Murābaḥa.*
[68] Pitcher, *Management Accounting*, p.11.
[69] FIBE, *'Aqd Bay' al-Murābaḥa.*

The bank's rights are well protected in the contract. The client's and his guarantor's all moveable and immoveable property can be used to meet the obligations arising from the *murābaḥa* contract. According to the Jordan Islamic Bank (JIB) *murābaḥa* contract, "the client and the guarantor agree that the bank has the right to implement against them, collectively or individually, any judgement or decision issued, either on all of their assets or the assets of one of them, moveable and immoveable."[71]

In addition to all these, the client should, on request, deposit with the bank cheques for each instalment, dated according to the date of maturity. The bank has a right to present the cheque for collection on the due date, if the client does not pay his instalment when it is due.[72] All this will ensure, to near certainty, the repayment of the *murābaḥa* debt. Such a stand on security by Islamic banks does not justify their criticism levelled at traditional banks' policy on security. In fact, it could be said that if such is the emphasis on security in Islamic banks, their practice is no better than that of traditional banks in this respect.

Relationship between the bank and the murābaḥa client. Islamic banking theory holds that the dominant characteristic of the relationship between the Islamic bank and its client is 'partnership based on PLS'. This characteristic, it is argued, eliminates the debtor-creditor nature of the traditional bank-client relationship.[73] However it is hard to justify this theoretical stand given the importance of *murābaḥa* operations in Islamic banking, which amount to more than seventy-five percent of the investment operations of these banks in general.

In *murābaḥa*, the sale contract entails a relationship of debtor-creditor between the client and the bank respectively. The buyer agrees to pay the cost of the goods plus the mark-up in instalments, the amounts and dates of maturity of which are specified in the contract.[74] As soon as the bank and the client enter into this contract of sale, the sale price becomes a debt obligation on the part of the client to the bank. Thus the relationship of the client to the bank becomes that of debtor-creditor. This is also the dominant, though not by all means the exclusive, relationship between the traditional bank and its customer.

Settlement of the debt. Financing a venture on the basis of *murābaḥa* to be repaid at a particular point in time does not differ greatly from financing a venture on the basis of fixed interest. In both cases, it is a debt, and the

[70] JIB, *'Aqd Bay' al-Murābaḥa.*
[71] Ibid.
[72] Ibid.
[73] IAIB, *al-Mawsū'at al-'Ilmiyya*, V, p.193.
[74] JIB, *'Aqd Bay' al-Murābaḥa.*

cost of financing, whether it is called interest or profit, is fixed, and the time allowed for repayment is also fixed. The most significant difference should be in the case where the debtor fails to repay the debt at the specified time. The loan at interest would generally incur an extra interest penalty if the loan is not paid upon maturity, whether the debtor was able to pay or not. In the case of an Islamic bank, the debtor should be given time for repayment if he is unable to pay according to the Qur'ānic instruction, "if the debtor is in difficulty, give him respite till ease."[75] Such time should be given without adding any extra burden on the debtor against the time given for payment. However, in practice, Islamic banks, with the support of their RSBs, have narrowed the meaning of the instruction. The general applicability of this command, as viewed by the Islamic banks, is a potential loophole for their debtors who might be remiss in paying their debts despite being able to do so. To stop potential abuse of this loophole, the RSBs of Islamic banks have accepted the concept of a 'fine' against those who fail to pay their debts on time, especially if the debtor is able to pay.[76] The definitive meaning of 'ability to pay' is difficult to determine in this context, as Islamic banks generally ensure from the outset of a *murābaḥa* contract that their advances are well secured, and as such are insured against any risk of default or delay in payment. This ensures the payment of the *murābaḥa* price plus mark-up to the Islamic bank and, in addition to this, a 'fine' for late payment can be imposed upon the client, who will be obliged to comply.

The 'fine' penalty reflects the loss suffered by the bank because of the non-payment of the debt on time. As Islamic banks look at their 'normal rate of return' to determine the 'fine penalty',[77] it is comparable for all practical purposes to the interest penalty of traditional banks, when loans are not paid on time. In the case of both the Islamic bank and the traditional bank, it is the 'normal rate of return' or 'opportunity cost of capital', which both of them are seeking to recover from the debtor. The Islamic bank uses the name 'fine' whereas the traditional bank refers to it as 'interest' but both mean the same thing. The Faisal Islamic Bank of Egypt in its contract of *murābaḥa* says:

> Since the bank does not deal with interest, any delay in paying the instalments when they are due as agreed upon causes serious harm to the bank, which requires compensation. This is on the basis of the *sharī'a* rule that no harm should be inflicted on any party [to the contract], which is the basis of transactions. This is according to the decision made by the three Religious Supervisory Boards of the *Dār al-Māl al-Islāmi*, the FIBE and the Faisal Islamic Bank of Sudan (FIBS) in their conference. Therefore, the two parties agree that in case of delay by the second party in paying any instalment on its due date, the bank has a right, without any objection or dispute [by the client], to demand compensation for any damages occurred because of the delay. The value of this damage will be calculated on the basis of average realised profit for the period in addition to any other compensations. Any dispute in relation to whether FIBE deserves compensation or not, or the value of such compensation will be decided by the RSB.[78]

[75] Qur'ān 2:280.
[76] FIBE, *'Aqd Bay' al-Murābaḥa*.
[77] Ibid.; Moḥammed, "Islamic Banks' Practices in Murābaḥa", pp.17-8.

The Banque Misr (Islamic branches) has gone so far as to declare a percentage (presumably of the principal due) as an initial compensation. The relevant term of the contract says:

> In case the *murābaḥa* account with the bank shows a debit balance [presumably after a certain period of time], the client must pay it immediately without any notice. Where the client does not pay, the bank has a right to take legal action for payment of this debt. It also deserves an initial and immediate compensation at the rate of ____ [percentage] without any warning, excuse or legal judgement.[79]

Even though the debt is fixed in a *murābaḥa* sale, in the sense that the amount of debt cannot vary after the contract is concluded between the bank and the buyer, the bank is able to protect its investment if the buyer does not pay on time. Commenting on the Pakistani experience with trade-related financing, Tim Ingram of Grindlays Bank (Pakistan) says:

> The system that has been adopted in Pakistan in these forms of mark-up finance, to put it into interest-bearing terms, is that, in the document, we charge what would amount to roughly seven months' extra interest into the mark-up. In other words, we may buy from a customer a stock for $100; he immediately enters into a contract to buy it back from us at $120, which he has to pay in six months' time. Now on a western interest-bearing basis, that would amount to about 40 percent per annum, which is much more than the bank really wants to see. So what we have is alternate documentation, a prompt payment rebate, which the customer receives.[80]

All these indicate that even in the settlement of debt, Islamic banks have devised means by which to ensure that the debt is paid on time, and if it is not paid, the "loss" suffered by the bank be compensated for by the client.

The Islamic bank's role in murābaḥa is that of a financier not that of a seller

Based on the above discussion, the Islamic bank's role in *murābaḥa* could be described more accurately by the term 'financier' rather than that of the 'seller' of goods. The bank neither handles the goods, nor takes any risks in relation thereto.[81] The bank's work is almost totally related to the han-

[78] FIBE, *'Aqd Bay' al-Murābaḥa*.
[79] Banque Misr, *'Aqd Bay' al-Murābaḥa*.
[80] Ingram, "Islamic Banking: A Foreign Bank's View", p.57.
[81] Rabooy, *Islamic Banking in Theory and Practice*.

dling of related documents. The contract of sale is a mere formality.

The request for purchase by the client is accompanied by a 'promise to purchase' attached to the down payment "to ensure that the client is serious in his purchase request" and that he will complete the purchase when the bank expresses its readiness to 'deliver' the goods. In the 'promise to purchase' it is also stated that the client promises to conclude the sale and purchase contract (*murābaḥa* sale contract) as soon as the bank informs the client that the goods are ready for delivery, or that the documents relating to the goods have arrived.[82] The sale contract would be concluded immediately after the bank is informed by its correspondent bank that the exporter is ready to deliver the goods, or after the documents arrive at the bank. The bank does not wait for the goods to arrive to examine them before delivering them to the buyer. In fact, their condition is not of much concern to the bank since it is the responsibility of the buyer to check the specifications of the items, before signing the contract in which the client affirms that he cannot have recourse to the bank for any defects in the goods.[83] If any defects occur in handling, this would be taken care of by the insurance company, the cost of which is included in the price and, hence, borne by the buyer. Since the carrier (shipping company or airline or other) is regarded as the 'agent' of the bank in relation to the goods, the buyer would be able to deal with all resulting problems with the carrier, without resort to the bank. Furthermore, the Islamic bank eliminates the possibility of having to pay any unknown expenses in a *murābaḥa* transaction. The FIBE *murābaḥa* contract, for instance, says:

> The client is responsible for all other expenses which are not included in the cost structure of this [*murābaḥa*] contract, and also for all costs arising from cancellation of a documentary credit, or refusal of the exporter to supply the goods. The client does not have any right to demand from the bank any compensation in case the exporter refuses to supply the goods for any reason whatsoever.[84]

The above discussion indicates that although *murābaḥa*, on the surface, appears to be a contract of sale under Islamic banking, it is a form of financing based on a predetermined return which is not much different from financing on the basis of fixed interest.

Murābaḥa profit, interest and riba

In their investment operations, Islamic banks seem to regard an outward conformity to Islamic legal injunctions as the most important determinant of the islamicity of their operations as the case of *murābaḥa*, the most important financing technique of Islamic banking in practice, indicates.

[82] FIBE, *'Aqd Bay' al-Murābaḥa*.
[83] Ibid.
[84] Ibid.

Islamic banks argue that the Qur'ān allows trade, that is buying and selling at a profit, and *murābaḥa* is also buying and selling at a profit. Since there are no legal restrictions on the amount of profit one can make from a particular sale, Islamic banks are theoretically free to charge whatever mark-up they can in a *murābaḥa* contract. These banks tend to interpret *riba* as occurring mainly in the context of financial transactions, that is, contractual obligations to pay an increase by the borrower in a loan. They also seem to argue that neither the Qur'ān nor the *sunna* specifically says that any increase against time given to pay a debt (as in the case of *murābaḥa*) is *riba*. A Western observer of the progress of Islamic banking remarks:

> For the Islamic banks, especially their advisers in Islamic law, the prohibition of interest is not mainly an economic problem, as it is for Muslim economists, who claim the allocative and distributive superiority of an interest-free system, but it is first and foremost a legal prescription. Prohibited is any predetermined positive return to the provider of capital in a purely financial transaction, that is, where an entrepreneur receives from a bank liquidity or money for utilisation at his own discretion. *Murābaḥa*, mark-up or *ijāra*, leasing, are not such purely financial transactions, because the entrepreneur does not receive liquidity or money but real assets, i.e., merchandise or machinery.[85]

It has often been argued that the mark-up and profit-margin techniques in trade and rent are nothing other than interest by a different name. In fact, from an economic point of view, there is indeed no substantial difference between mark-up and interest. The main difference between the two is a legal one: the bases for interest are loan contracts while mark-up or rent is founded on sale or lease contracts. These legal differences do not seem to make the profit margin in *murābaḥa* much different from the fixed interest on a loan. In economic terms, financing on the basis of mark-up in price (*murābaḥa*) has no significant economic merit over the interest-based system, except that genuine financing cannot be provided under mark-up deals if there are no goods to be transacted as, for instance, in services.[86] Zaidi says:

> In my opinion the cost of credit in bank financing on the basis of *murābaḥa* or mark-up in price, is the same as in the case of financing on the basis of simple interest, except that in *murābaḥa* financing, the price agreed remains the same even if the payment is not made on the due date.[87]

Ziauddin Ahmad, one of the theoreticians of the Islamic banking movement, was highly critical of the replacement of interest by 'mark-up':

> [That] replacement of interest by a technique like "mark-up" does not rep-

[85] Nienhaus, "Islamic Economics, Finance and Banking", p.44.
[86] Zaidi, N.A."Islamic Banking in Pakistan", p.29.
[87] Ibid.

> resent any substantive change becomes apparent if one ponders over [sic] the philosophy behind the prohibition of interest. It is easy to see therefore, that the mark-up system, and for that matter all other devices which involve a fixed pre-determined return on capital, are no real substitutes for interest. It has also been pointed out that *bay' mu'ajjal* [*murābaḥa*] are trade-specific practices rather than financing techniques. Their use may therefore be alright for those engaged in trade as a profession but it is stretching the permission in *sharī'a* too far to use them as general financing devices.[88]

The theorists of Islamic banking from the 1940s to the late 1970s did not envisage Islamic banking as banking on a "mark-up" basis. They saw it as being based on Profit and Loss Sharing (PLS) utilising the concepts of *muḍāraba* and *mushāraka*. Siddiqi's *Banking without Interest* does not make any reference to *murābaḥa*, nor does Uzair's *Interest-free Banking*. The Council of Islamic Ideology report (Pakistan), perhaps the most important document on Islamic banking, allowed the use of *murābaḥa* only hesitantly, and even then limited its use to unavoidable cases in the process of change to the interest-free system. It also warned that "it would not be advisable to use it widely or indiscriminately in view of the danger attached to it of opening a back door for dealing on the basis of interest."[89]

Even though *murābaḥa* is allowed by many early jurists, its relevance remain basically in trade, where traders deal with goods. The problem arises when this instrument is utilised extensively in financing. Banks, by nature, are not traders in goods, but financiers. According to the Council of Islamic Ideology (CII):

> The fact of the matter is that 'mark-up' is a crude trading practice which has been permitted by certain religious scholars under specified conditions. Its permissibility is questioned by other scholars. In any case, it is a device which is relevant in the contract of transactions between a seller and buyer of goods. Banks are not trading organisations. They are essentially financial institutions which mobilise funds from the general public and make them available to productive undertakings. It should, therefore, be abundantly clear that if the banking system is to be Islamised, mark-up is no solution and some way has to be found which preserves the financial character of the banking institutions and steers clear of interest which is prohibited by Islam.[90]

Therefore, a change from an interest-based system to a mark-up based system is merely a change of name, leaving the substance intact. Considering the implications of the *murābaḥa* system, Siddiqi succinctly summarises the whole issue in one sentence: "For all practical purposes this [the mark-up system] will be as good for the bank as lending on a fixed rate of interest."[91]

[88] Ahmad, Z, "The Present State of Islamic Finance Movement". pp.23-4.
[89] CII, *Consolidated Recommendations*, p.124.
[90] Ibid.
[91] Siddiqi, *Issues in Islamic Banking*, p.139.

Recognising the same implication of the mark-up system, the CII is highly critical of it:

> There is a genuine fear among Islamic circles that if interest is largely substituted by 'mark up' under the PLS operations, it would represent a change just in name rather than in substance. PLS under the mark-up system was in fact the perpetuation of the old system of interest under a new name. [92]

Because of its inherent dangers, Siddiqi argues in favour of excluding the instrument of *murābaḥa* from Islamic banking altogether. He says:

> I would prefer that *bay' mu'ajjal* [*murābaḥa*] is removed from the list of permissible methods altogether. Even if we concede its permissibility in legal form, we have the overriding legal maxim that anything leading to something prohibited stands prohibited. It will be advisable to apply this maxim to *bay' mu'ajjal* in order to save interest-free banking from being sabotaged from within.[93]

Concluding remarks

Murābaḥa, a form of deferred payment sale, and a purely commercial contract, although not based on any text of the Qur'ān or the *sunna*, has been allowed in Islamic law. Islamic banks have utilised the *murābaḥa* contract in their financing activities where goods are involved, and have expanded the scope and extent of its use. Such financing now comprises more than seventy-five percent of Islamic banks' financing by virtue of its having a predetermined return on the banks' investments, much like the predetermined return of interest-based banks.

Murābaḥa finance and the higher credit price involved therein has clearly shown that there is a value of time in *murābaḥa* based finance, which leads, albeit indirectly, to the acceptance of the time value of money. It has been conveniently ignored that accepting the time value of money logically leads to the acceptance of interest. Accepting time value in *murābaḥa* transactions (which, as has been shown in this chapter, is scarcely any different from a purely monetary transaction) and then rejecting the same in monetary transactions appears to be inconsistent and illogical. If Islamic law can allow *murābaḥa* financing as it is practised under Islamic banking then the question is, "Is there any moral basis for not allowing fixed interest on loans and advances?"

[92] CII, *Consolidated Recommendations*, pp. 97, 121.
[93] Siddiqi, *Issues in Islamic Banking*, p.139.

> resent any substantive change becomes apparent if one ponders over [sic] the philosophy behind the prohibition of interest. It is easy to see therefore, that the mark-up system, and for that matter all other devices which involve a fixed pre-determined return on capital, are no real substitutes for interest. It has also been pointed out that *bay' mu'ajjal* [*murābaḥa*] are trade-specific practices rather than financing techniques. Their use may therefore be alright for those engaged in trade as a profession but it is stretching the permission in *sharī'a* too far to use them as general financing devices.[88]

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[92] CII, *Consolidated Recommendations*, pp. 87, 123.
[93] Siddiqi, *Issues in Islamic Banking*, p.139.

CHAPTER SIX

DEPOSITS AND DEPOSITORS

This chapter makes a brief examination of several issues relating to the deposit mobilisation aspect of Islamic banking. The chapter first discusses the participation of the Muslim populace in the deposit mobilisation effort. It then proceeds to discuss several key issues relating to the bank-depositor relationship questioning the stand taken by the Islamic banks on these key issues: return on demand deposits, small savings and inflation, provision of interest-free loans, liability for investment deposits and profit distribution.

Interest, deposits and Muslims

Islamic bankers are generally of the view that saving is desirable, even a necessity in today's quest for the economic and social development of Muslim communities, where channelling savings to productive sectors of the economy is seen to be one of the most important factors conducive to development.[1] However, many Muslim countries are among the least developed countries (LDCs) with a low per capita income. Although some LDCs save a relatively high percentage of their national income, in many of them saving is very low. Due to the low level of per capita income in these economies, even a fairly high percentage rate of domestic saving yields only a limited amount of new capital. As a result, most LDCs, with the exception of oil exporters, have depended on capital inflows from abroad to help finance development.[2]

Proponents of Islamic banking have been arguing that even the low income Muslim communities can contribute significantly and positively to the development of their communities by participating in the process of capital formation. This, they assume, would be achieved by adopting the 'habit of banking', or by putting savings in the banking system instead of hoarding or saving in the form of real assets like gold or silver.[3] These proponents contend that, given the availability of suitable institutional mechanisms, those Muslims who are out of the banking system can be attracted to the savings process. They argue further that the present traditional banking system, to a large extent, is unsuitable for that purpose, as the banking system is run on principles which are against the religious conviction of many Muslims, particularly in relation to the issue of interest.[4] Therefore, traditional banks and financial institutions which are based on interest are thought to deter many Muslims from dealing with them. According to Siddiqi (1983b), a pioneer in the theory of Islamic banking, "one of the major reasons why the banking habit [has] never put down deep roots in Muslim societies has been interest."[5]

[1] IAIB, *al-Mawsū'at al-'Ilmiyya*, I, p.260; Ṭā'il, *al-Bunūk al-Islāmiyya*, pp.57-9.
[2] Dolan, *Macro-Economics*, pp.539-40.
[3] Najjār, *Bunūk bila Fawā'id*, pp. 50-6; Abdeen and Shook, *The Saudi Financial System*, p.181.

Siddiqi's claim, however, is yet to be substantiated. Reliable estimates of the number of Muslims who avoid the banking system because of interest are not given in the Islamic banking literature although it has been asserted that there is a large number of people outside the banking system.[6] The contention of the proponents of Islamic banking that it is the interest factor which is inhibiting a large number of Muslims from effectively participating in the capital formation should not, however, be exaggerated. The Islamic banks, in comparison with the interest-based traditional banks, are still a small minority even in the Muslim world, and the deposits of Islamic banks have not yet increased considerably at the expense of the traditional interest-based banks. The share of total deposits of the Islamic banks in the Deposit Money Banks' (DMBs) deposit market in their respective countries where Islamic banks and interest-based banks operate side by side is rather small. This market share ranges from five to twenty percent, and is in many cases less than ten percent. This indicates, though rather indirectly, that it is still a minority sector within the Muslim community, who avoid traditional banks because of their conviction that interest is prohibited. It is almost twenty years since the first commercial Islamic banks appeared, and if interest was the inhibiting factor, the Islamic banks would have been able to increase their share of deposits significantly.

Even in the case of Pakistan, according to the Pakistani scholar Shahrukh R. Khan, when Islamic banking was introduced in the 1980s there was no sudden influx of Profit and Loss Sharing (PLS) deposits to the banks. Money which entered the PLS system came mainly from existing deposits with very few new PLS funds. The depositors on a PLS basis appear to have been motivated largely by financial gain rather than by a religious conviction that interest is forbidden.[7] The government of Pakistan, in its drive to promote Islamic banking, has made sure that the 'profit' given to the PLS depositors is higher than the available interest, providing the incentive for the depositors to put their saving in PLS deposits. In his discussion on PLS deposits, Shahrukh R. Khan concludes:

[4] Najjār, *Bunūk bila Fawā'id*,pp.43-5.
[5] Siddiqi, *Issues in Islamic Banking*, p.11.
[6] Abdeen and Shook, *The Saudi Financial System*, p.181; Wohlers-Scharf, *Arab and Islamic Banks*, p. 76.
[7] Khan, *Profit and Loss Sharing*, pp.141-3.

> Had there been a jump in deposits in 1981 with continuously higher growth rates thereafter, one would have reason to suspect that money out of circulation was being introduced into the banking system. In that case, it would have been worth investigating the extent to which PLS was responsible for the change. As such, there is no evidence to suggest that people were avoiding the banking system on a large scale because its interest dealings went against their religious sentiments.[8]

The avoidance of the banking system by a significant segment of the Muslim population, if this is in fact the case, could, however, be attributed to several factors. Among them are the level of development of the country, the level of poverty, the lack of availability of banking and financial services to the people by means of extensive branch networks, an underdeveloped savings mentality, distrust of the political system and the institutions emanating from it including the banking system, or the perception of the masses that the bank is not somehow an indigenous institution. Another reason could be the perception that the banks are serving the interests of the relatively well-off, not the low-income strata of the community.[9]

Islamic banks and the depositor-bank relationship

The stand generally taken by Islamic banks on several aspects of the bank-depositor relationship appears to have had an adverse effect on depositors. Generally speaking, Islamic banks tend to justify their stand by resorting to a legal point or a *sharī'a* text. The purpose of the following discussion is to highlight problematic areas from the point of view of the depositors rather than dealing with each issue in-depth, which is beyond the scope of the present work.

Return on demand deposits. When Islamic banking theory began to be developed from the 1940s through to the 1970s, in the industrial world as well as in the least developed countries, demand deposits and current account deposits were generally on an interest-free basis.[10] Since no interest was paid to these deposits Islamic banking theorists argued that the demand deposits were Islamic.[11] The islamicity of demand deposits and the non-provision of any return on them were justified by relying on various provisions of Islamic law. The gist of their justification is set out below.

As viewed by the banks, the Islamic basis of demand deposits (at-call deposits) is the concept of *wadī'a.*[12] *Wadī'a* is defined, according to the Māliki school of law, as "setting up an agency contract for the purpose of protecting one's wealth."[13] The definitions given by Ḥanafis, Shāfi'is and Ḥanbalis agree on the main element of this definition, which is, the delegation to another party of the function of protecting one's wealth.[14] When money is deposited with the bank, the money, according to this view, is for protection, or in other words, for safekeeping. It is also generally agreed among the early jurists that when the object of *wadī'a* is money, the contract of *wadī'a* would automatically be transformed into a contract of loan (*qarḍ*). Two points arise from this. One is that, according to the rules relating to loan, it is believed that the Islamic bank cannot guarantee a positive return to the depositor. If the depositor is interested in a return, there is no guarantee of the protection of the deposit since earning a return could only be achieved by putting the deposit at risk on a Profit and Loss Sharing (PLS) basis. A return on the deposit and, simultaneously, protection of the deposit from the risk of loss do not go together, according to this view. The second point is, since the bank is a debtor, and the depositor a creditor, the debtor would have the right to use the loan in any manner he wishes. Based on this view, the Islamic bank would be at liberty to utilise the deposits as it sees fit, without any interference from the depositor as to how, when and where the deposit could be used. Any return on the utilisation would be for the bank and the depositor has no right to a share of the return. According to the Islamic banking theorist, Siddiqi:

> if the bank suffers any loss in transaction with the loan capital the loss must be borne by the bank itself and the account holder remains entitled to the return of the amount in full. Similarly, if the bank earns profit out of it, the profit will go to the bank and the account holders will have no share in it, being entitled only to the actual amount deposited.[15]

The Islamic banks' argument is that since the bank is in fact 'borrowing' money from the depositor, it is only obliged to return the amount loaned, the depositor not being entitled to any return, on the basis of the rule in Islamic law that "any loan which begets any advantage is *riba*" even though the bank has utilised the deposit.[16] Since any concept of loan indexation for the loss of purchasing power of money is not accepted by Islamic economists and bankers, even indexation of demand deposits would also be

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[8] Ibid., p.141.

[9] That a bank based on interest can become extremely successful in the capital formation process, and in raising the standards of living of the people even among the poorest sections of the community, is exemplified by the Grameen Bank of Bangladesh. Although the Grameen Bank was based on interest, the nature of the bank and its concern for the poor and the humane way it approached its clients led to its success. Its success was not hampered by interest.

[10] Ghanameh, "The Interestless Economy", p.59.

[11] IAIB, *al-Mawsū'at al-'Ilmiyya,* V, pp.142, 157-61.

[12] Ibid., pp.144ff.

[13] Jazīri, *Fiqh,* III, p.248.

[14] Ibid., pp.248-9.

[15] Siddiqi, *Banking without Interest*, pp.48-9.

[16] According to the *Mawsū'a* of IAIB, "if it became clear to us that the relationship between the bank and its current account depositor is that of a debtor-creditor or that of a borrower-lender, either in depositing or withdrawing, the rule of Islam should be applied. The rule of Islam in this relationship is that it is lawful as long as there is no element of *ribā*." IAIB, *al-Mawsū'at al-'Ilmiyya,* V, p.160.

seen as *riba*.

Small savings and inflation. Savings deposits, as generally accepted under Islamic banking, may have serious consequences for the value of such savings, especially in countries where inflation is running at double-digit levels or, in extreme cases, triple-digit. The commonly accepted interpretation of *riba* among Islamic banking theorists as well as practitioners is that, in repaying debts, the borrower is obliged to pay only the nominal amount of the original debt. This implies that a savings depositor under Islamic banking would be receiving the nominal amount of the deposit regardless of inflation. If this is the case, then, in an inflationary situation, the value of the savings deposit may be eroded in a short period of time if there is no corresponding compensation in the form of a return on the deposit.

Islamic banking proponents, however, argue that the answer to the problem lies with the depositor not with the Islamic bank. They argue that in Islam, risk-taking is commended and, if the depositor is interested in getting any return, he should take the risk and put his money in an investment deposit account. Such a response, however, does not address the real issue involved, which is one of fairness, justice and equity. The discussion in chapter 8 will indicate that such a simplistic answer to a major problem is not justifiable.

Provision of interest-free loans. Since demand deposits constitute a source of free funds for an Islamic bank as the bank is under no obligation to pay any return on them, some Islamic banking proponents[17] suggest that these institutions should provide interest-free loans to businesses as well as to consumers from these funds.[18] This social function of demand deposits under Islamic banking is recognised by the International Association of Islamic Banks which states:

> As for the Islamic bank, the accumulated funds in demand deposit accounts represent an important source of support for undertaking certain activities which serve to fulfil its obligation towards society. This is by means of the provision of short term finance to meet the urgent financial needs of various productive activities in the community.[19]

Despite the fact that in some Islamic banks, specially those of Sudan, Bangladesh, Jordan and Dubai, demand deposits make up a significant part of their total deposits, these banks do not appear to provide interest-free loans to individuals or businesses at a significant level. It is perhaps the opportunity cost for the Islamic bank in providing interest-free loans which inhibits them from advancing such loans on a relatively large scale. Islamic bankers, in practice, recognise the considerable importance of the time value

[17] Siddiqi, *Banking without Interest*, pp.48-9.
[18] Mawdūdi, *Riba*,p.141.
[19] IAIB, *al-Mawsū'at al-'Ilmiyya*, I, p.12.

of money.[20] Advancing money on an interest-free basis would incur a 'cost' for the bank which would equal the opportunity cost represented by the return the Islamic bank could have earned, had the interest-free loan been utilised in an investment operation. Since the Islamic bank's advances and returns on these advances are calculated to some extent by taking into consideration comparable returns (interest) on traditional banks' advances,[21] the opportunity cost would be approximately equal to the interest charged by other banks for similar advances.

However, where the Islamic bank can recover this cost in some way, it provides interest-free loans. Funds placed in *nostro* accounts with correspondent banks is a case in point. The Islamic bank and the correspondent bank recover the cost of the interest-free deposit with each other in two ways: (i) reciprocal exchange of funds and by mutually agreeing not to charge interest on either the *vostro* or *nostro* account, even if the accounts go into the red and (ii) the banking services provided 'free' by the correspondent bank for the Islamic bank, and by the latter for the former.

It is true that in such a case, there is no *explicit* charging or paying of interest, but the benefits from keeping funds have been achieved *in kind*. The bottom-line is, as long as there is compensation for their funds, Islamic banks are willing to provide 'interest-free' loans. If such compensation does not exist, as in the case of advancing interest-free loans to consumers, such advances are on a very limited scale.

Liability for investment deposits.[22] One of the most popular forms of deposits with an Islamic bank is the so-called investment deposit. Investment depositors place their funds in investment accounts and are supposed to share in the profit and loss of the investment operations of the bank.

Islamic banking theorists and bankers have taken the stance that the banks will not be liable for any losses suffered in their investment operations involving investment deposits. This is based on the view that such sums are deposited on the basis of the *muḍāraba* contract developed in Islamic law. The argument is that the investment depositors are to be regarded as investors in a *muḍāraba*, and since the capital in a *muḍāraba* is not guaranteed and the *muḍārib* is not liable for the loss, the Islamic bank as a *muḍārib* should not be liable.

Arguing that the basis of Islamic banking deposit mobilisation is based

[20] Moḥammed, "Islamic Banks' Practices in Murābaḥa", pp.16-8; Quasim, "Islamic Banking: New Opportunities", p.25.
[21] Quasim, "Islamic Banking: New Opportunities", p. 25; Interview with 'Abd al-Qādir al-'Ush of the Jordan Islamic Bank on 23.11.1989.
[22] Investment deposit accounts in Islamic banking correspond to term deposit accounts and to some extent, savings deposits under traditional banking. The main purpose of an investment deposit account at an Islamic bank is to earn a return for the amount invested on the basis of Profit and Loss Sharing (PLS).

on *muḍāraba*, Siddiqi says: "The bank will seek to persuade the general public to put their savings with the bank on *muḍāraba*."[23] Sami Homoud (1986), a pioneer in the theory of Islamic banking, realised the difficulties involved in applying the traditional *muḍāraba* to the relationship between the depositor and the bank for the following reasons. The traditional *muḍāraba* was a bilateral contract between the investor and the *muḍārib* who invests the money within the limitations specified by the investor. When he begins to invest the funds, a third party may not join the *muḍāraba* as an investor by providing fresh capital. Neither can the same investor provide fresh capital for the *muḍāraba*. Nor should the *muḍārib* mix funds advanced for two separate agreements even if the investor is the same in both cases. The investor may impose certain conditions on the *muḍārib*, like the type of business to invest in. He may not allow the *muḍārib* to give the funds to a third party on a *muḍāraba* basis, or he may rescind the contract and demand the conversion of the capital to money, along with its return. The profit is also dependent on the liquidation of *muḍāraba* goods.[24] The limitations of the traditional *muḍāraba* were so many that Homoud rejected it as a sound basis for the relationship between the investment depositor and the bank, and instead suggested what he called a 'common *muḍāraba*' (*muḍāraba mushtaraka*) in which all the limitations put on the traditional form are avoided.[25] In this common contract, there are three parties: the depositor, the bank (intermediary) and *muḍārib*s (third parties seeking finance from the bank). The bank has a dual role: on the one hand it is a *muḍārib* in relation to the depositor, and on the other hand it is an investor in relation to the *muḍārib* (the third party).

Rafiq al-Miṣri, a writer on Islamic banking, criticised this dual role of the bank.[26] In his view, the relationship on the basis of *muḍāraba* is very complicated and unsuitable. He maintains that the bank is an intermediary or agent, working on the basis of a fee or commission. Abu Saud, another contemporary theorist, also rejected the notion that *muḍāraba* could be a sound basis on which to base the relationship between the depositors and the bank, and raised a series of interesting questions on the issue, stating:

> One can see that it is not practical (if ever possible) to marry *qiraḍ* [*muḍāraba*] with the present banking system. Banks are not allowed to directly engage in commercial or industrial operations or in any speculative transactions, while *qiraḍ* is based on engaging in all such risky operations. But what if we allow banks to do so? What if we allow banks to accept savings on condition that they would directly invest them in different enterprises? The same question arises again: Who would take the risk? If it is the bank, why should A [the depositor] take any profit at all? If A would take the risk, why go to the bank at all?[27]

[23] They argue that since the bank is a *muḍārib* it can guarantee neither a positive return nor the capital invested. This means that, in case of loss, "the loss will be spread over the entire capital of business. The loss apportioned as a result of such calculation will be borne by each account-holder (depositor)." Siddiqi, *Banking without Interest*, p.39-40.
[24] Homoud, *Islamic Banking*, p.213.
[25] Ibid., pp.220ff.
[26] Miṣri, *Maṣraf al-Tanmiyat al-Islāmi*, pp.240-1.

Despite the reservations of such prominent theorists, Islamic banks have maintained that the relationship between the bank and the depositors should be on a *muḍāraba* basis.[28] At the same time, the banks have generally selected those features of the *muḍāraba* contract as developed in Islamic law which are in the best interests of the banks, and ignored those features which are not. In line with this, they have emphasised the liability of depositors for the losses which might result from the banks' investment operations. In the investment of funds, they have resorted to the 'total freedom' of the *muḍārib*, a concept derived from the *muḍāraba muṭlaqa* (absolute *muḍāraba*) of the Ḥanafi school of law.[29] However, when it comes to the depositors' say or role in the management of *muḍāraba* the banks throw up barriers. In fact, the investor cannot dictate the terms of the *muḍāraba* to the bank or have any representation on its board. The Faisal Islamic Bank of Egypt (FIBE), for instance, in its application form for opening an account, states:

> The bank is the legal agent of the depositors in general in investing their deposits according to the rules of the *sharī'a*, and the bank has the capacity to determine investment activities and to select the personnel to undertake such activities.[30]

The insistence on *muḍāraba* as the basis for the relationship between the investment depositor and the bank absolves the bank of any liability for the investment depositors' funds. Writers on Islamic banking hold two main views in relation to the liability for the deposits. Most writers state that the depositors should be held liable for any losses arising from the bank's utilisation of funds. Their argument is based on one main issue: the ruling in Islamic law that in *muḍāraba*, the *muḍārib* should not be held liable for any losses he makes in the course of business, and that the return of capital cannot be guaranteed. Islamic bankers have maintained that this view should be followed citing that there is agreement among the jurists on the issue. According to Ibn Qudāma, whenever the investor stipulates that the *muḍārib* is liable for the capital or part of the loss, the stipulation is void.[31] According to him, this is the view of the *imāms* of various schools of law: Abu Ḥanīfa, Mālik, Shāfi'i and Aḥmad b. Ḥanbal. No text from the Qur'ān or *sunna* is added to support this view. The present writer was unable to find any explicit text from the Qur'ān or *sunna* in support except a saying

[27] Abu Saud, "Money, Interest and Qiraḍ", p.72.
[28] Ṭā'il, *al-Bunūk al-Islāmiyya*, p.68; KFH, *A Collection of Booklets*.
[29] KFH, *A Collection of Booklets*.
[30] FIBE, *Application for Opening an Account*.
[31] Ibn Qudāma, *Mughni*, V, p.67.

attributed to 'Ali b. Abi Ṭālib in which he said: "The loss is on the capital and the profit is as agreed upon between the parties."[32] The problem with this saying is that it is, at best, the saying of a Companion, not of the Prophet, and therefore, not binding.

Other contemporary writers such as the Shī'i scholar Bāqir al-Ṣadr (1973) and Homoud (1986) have found the question of liability a vexing one. The investor under the traditional *muḍāraba* assumes any loss arising from the venture provided the *muḍārib* has not misused the funds. Accordingly, it would be the depositors who assume this liability, which would be a considerable disincentive to depositing funds with the Islamic bank. Bāqir al-Ṣadr attempted to solve this difficulty by stating that the Islamic bank voluntarily accepts the liability for the funds thus absolving the depositors. His reasoning was that even though the bank is called the *muḍārib*, it does not invest the funds by itself, but advances the funds to third parties who invest them in the real sense of the term. Hence, even if the bank assumes liability it is not the *muḍārib*, and the traditional ruling that the *muḍārib* shall not bear liability remains valid. There is some support for this view in Islamic law. According to Ibn Rushd:

> the leading jurists of various cities did not differ on the point that if the *muḍārib* hands over the capital of *muḍāraba* to a third party on a *muḍāraba* basis, the *muḍārib* is liable if any loss results.[33]

But the question arises, if the depositor is not liable for loss and his capital is guaranteed, what is the justification for receiving profits? A justification could be found in the Ḥanafi view that profit can be the result of either the provision of money or liability or risk.[34] If this is accepted then the mere provision of money to a venture without assuming any risk or liability will entitle the provider to profits. But this proposition, if accepted, could shatter the foundations of *riba* theory as it is accepted in Islamic banking. This is because any gain for funds advanced for a venture without assuming risk is regarded in Islamic law as *riba*. It is apparently sensing this danger that Rafiq al-Miṣri (1977) subjected this Ḥanafi view to criticism and concluded that the "correct" view should be that *money which assumes risk* is the reason for profit, and mere provision of money does not entitle a person to share in the profits of a venture.

In practice, Islamic banks have found that the ruling in Islamic law, according to which the *muḍārib* is not liable for any losses, is in the interests of the bank. On the basis of this, almost all of these banks currently in operation hold the investment depositor liable for any losses they may incur in any given financial year. The shareholders of these Islamic banks are in this

[32] Shawkāni, *Nayl al-Awṭār*, V, p.266.
[33] Ibn Rushd, *Bidāyat al-Mujtahid*, II, p.182.
[34] Miṣri, *Maṣraf al-Tanmiyat al-Islāmi*, p.268.

sense protected from this liability at the expense of the depositors.[35] That the *muḍārib* should not be held liable for the capital or any losses was suitable at a time when *muḍāraba* was practised as conceived in Islamic law. It was a contract where the capital owner was the stronger party by virtue of his provision of capital. The *muḍārib* had only his skill but no capital, and hence had to follow the dictates of the capital owner. This placed the *muḍārib* in the role of the weaker party. In such a case it would be unfair to put the burden of the loss onto him. The ruling in *fiqh*, therefore, was perfectly suitable to a *muḍāraba* as conceived in *fiqh*. But it is perhaps stretching the application of the rule too far when small savers put their hard-earned savings in a bank with its vast financial resources. In recognition of this fact, the "Law for Usury-Free Banking (1983)" of Iran allowed the banks to undertake and/or insure the principal of the investment deposits, thus protecting the interests of the depositors.[36]

Profit Distribution. The profit generated by an Islamic bank is largely the result of the utilisation of the depositors' funds plus the equity capital in various investment operations. Although the equity capital in relation to the depositors' funds does not form a significant part of the funds available for investment in Islamic banks, the depositors have no say in the allocation of income. This is more noteworthy in view of the importance of deposits relative to equity capital. In many Islamic banks, the equity to deposits ratio is less than ten percent, and in some cases significantly less than that.

The total profit realised at the end of a particular accounting period is not necessarily allocated to the depositors and the bank in proportion to their funds. A distinction is made between the profits belonging to the shareholders of the bank, and the profits accruing to the depositors. The Islamic bank invests its own funds with the funds of the investment depositors. Funds of the bank are the paid-up capital, reserves and retained earnings. Revenues generated from the investment of any demand deposits would also be for the bank since the demand deposits are treated as interest-free loans from the depositors to the bank. Income from fees and commissions on banking activities, as distinct from investment, are for the shareholders, not for the investment depositors. Since the bank is a partner with the depositors, a share of the investment income will be allocated to the bank. In short, all income earned from the investment of funds other than PLS deposits, commissions earned on various banking services and a percentage of the income of the PLS deposits for managing them, belong to the shareholders of the bank.

The depositors' profit, therefore, shall consist *only* of income generated through investment of their PLS deposits after deducting the bank's share as

[35] The reason for insisting on this rule, quite apart from the fact that it is 'unanimously agreed upon' by the jurists, appears to be that it is in the interests of Islamic banks to do so.
[36] Iqbal and Mirakhor, *Islamic Banking*, p.32.

remuneration for managing the investments.[37] This does not mean that the full investment deposit shares in the profit. The portion which must be kept as cash reserves receives no such share. Different Islamic banks follow different policies as to what percentage of profit is to be distributed to the depositors.

Return on investment (ROI) is basically determined by the amount deposited (subject to minimum deposit requirements and percentage of deposit eligible for participating in profit) and the time (generally months): *ROI = Amount x time*. Deposits whose maturity is longer receive higher returns. For instance, a deposit for a minimum period of 3 years will attract a higher return than a deposit for one year. The justification for differentiation among the investment depositors on the basis of time is not evident either in the literature on Islamic banking or in *fiqh*. The only justification which could be gleaned from the Islamic banks' annual reports is that the bank, in order to invest in long term projects, needs long term funds. Therefore, to encourage clients to keep their funds in long term deposits, the bank gives a higher return to such depositors. Nevertheless it should be kept in mind that this higher return, particularly the portion of the return which is over and above the return available to other depositors, is not given from the bank's share of the profits but from the income generated by the year's investment activities. It could be argued, therefore, that whatever the merit of long term deposits, there is a possible injustice to the investment depositors who receive a lower return, just because their deposit was for a shorter period. The bank, presumably, is distributing income arising from its annual investment activities, and it should be distributed fairly among the depositors, particularly when the Islamic bank takes its share of the profits from everything so scrupulously. Differentiation between the investment depositors on the basis of the term of the deposit does not seem to be in line with the claimed scrupulous and just methods followed by Islamic banks in income allocation. There would be no place for concern if the extra portion was given from the bank's own share of income.

Concluding remarks

This chapter has discussed briefly several issues of concern from the perspective of depositors. There is still not enough reliable evidence to suggest that Muslims on a large scale generally avoid depositing their money with interest based banks because of their conviction that interest is prohibited. Moreover, the available data on the market share of Islamic banks currently operating in interest-based environments also does not appear to provide strong support for the claim. The chapter also questions the stand taken by the Islamic banks on several key issues relating to the bank-depositor rela-

[37] Zaidi, "An Alternative Model of Islamic Banking", p.36.

tionship such as demand, saving and investment deposits, provision of interest-free loans and profit distribution. It seems that the depositors are at times disadvantaged because of bank policy.

CHAPTER SEVEN

RELIGIOUS SUPERVISORY BOARDS AND ISLAMIC BANKING

The most widely used approach to ensuring the islamicity of Islamic banking at private sector level, particularly in the Middle East, is that of the Religious Supervisory Board (RSB). Islamic banks employ scholars of Islamic law in a consultancy and advisory capacity to examine their contracts, dealings and transactions. This is to ensure that the day-to-day activities of the Islamic bank in the areas of resource mobilisation and allocation are in line with the *sharī'a*. In this chapter we identify the general characteristics of the RSB approach by reference to the legal opinions (*fatwa*s) issued by the RSBs of two prominent Islamic banks, namely, the Kuwait Finance House (KFH) and the Jordan Islamic Bank (JIB).[1]

The Religious Supervisory Board (RSB) method

The existence of Religious Supervisory Boards (RSBs) in almost all private sector Islamic banks operating in the Middle East in UAE, Kuwait, Bahrain, Jordan, Egypt and Sudan points, *inter alia*, to the religious character of these banks. In some banks, like the Jordan Islamic Bank, there is only one religious consultant, whereas in other banks such as the Faisal Islamic Bank of Egypt (FIBE), the board consists of five members at most, who are scholars of Islamic law and believe in the idea of 'Islamic banking'.[2] They are given wide powers and authority to examine any contract, method, or activity relating to the conduct of their banks. According to the Articles of Association of FIBE, the RSB would have at their disposal all the means which are available to the auditors, in order to perform their functions. In their banks' annual reports the RSBs certify that the activities of their institutions are according to the *sharī'a*, just as independent auditors certify that the financial position of the bank is fair.

The procedure followed by these Islamic banks to ensure the islamicity of their banking and financial operations could be briefly stated as follows: the management of the bank, when it faces a banking and finance problem which needs to be looked at by the RSB, analyses the problem to some extent, suggests a solution that could be adopted in contemporary banking and finance, explains the constituent elements of the suggested solution, gives an example for clarity, and seeks the opinion of the Religious Supervisory Board on its proposed solution. The Board considers it, and if, in its opinion, there is no objection to that solution from the *sharī'a* viewpoint, endorses it. If there are any objections to the solution or any of its constituent elements, the Board expresses its opinion on the matter, and recommends further modification to the unacceptable elements. The following is an example of how the management of the bank formally consults with the Religious Supervisory Board.

[1] The method followed by these RSBs in ensuring the islamicity of their operations is apparently consistent with the methods followed by the RSBs in other Islamic banks in the Middle East, and therefore, the result of this examination could be equally applicable to the practices in those banks, allowing for some slight individual variations.

[2] FIBE, *Articles of Association*.

The management of the Kuwait Finance House (KFH) seeks the opinion of its RSB on an issue and asks the following question:

> We request you to provide us with the *sharī'a* opinion on the lawfulness or unlawfulness of our buying certain goods for cash, on the basis of the request of a client, and his promise to buy those goods from us. Selling to the client would take place when we own the goods, and take possession of them. The client will buy the goods from us on a deferred payment basis, and at a higher price than the price we paid.[3]

The example is as follows:

> A person is interested in buying a commodity or certain goods, but he is unable to pay in cash. Therefore, we believe that if we buy the item and take possession of it, he will buy it from us on a deferred payment basis against a specific profit margin which is stated in his promise.[4]

The RSB expressed its opinion by saying:

> What the person who requested the purchase did is to be regarded as a promise. In view of the fact that the *imāms* differed among themselves with regard to such a promise, whether it is binding or not, I am inclined to take the view of Ibn Shubruma. He says that every promise which does not make a prohibited thing lawful, or a lawful thing prohibited, should be binding legally as well as religiously. This is what the Qur'ānic texts and *ḥadīth* indicate. Taking this view is the easiest for the people, and acting according to that will lead to conducting transactions on a more firm basis. There is no objection to implementing a condition like this...[5]

Main characteristics of the RSB method

A summary follows of the main characteristics of the RSB method of ensuring the islamicity of Islamic banking with examples to illustrate each point.

a. If there is a text in the Qur'ān or in the *sunna* which appears to be relevant to the problem at hand, the RSB does not go beyond the text. If there

[3] KFH, *al-Fatāwa al-Shar'iyya*, I, p.16.
[4] Ibid.
[5] Ibid.

is agreement by the jurists on a particular issue the RSB follows that as well. The RSB of the Kuwait Finance House (KFH) clearly states this by saying:

> If I find any text from the Qur'ān or *sunna*, I do not go beyond that whatever the circumstances are. As for the views on which there are differences of opinion among the scholars, I take the opinion which is lenient and easy for the people as long as the opinion is not a deviation or an isolated one.[6]

This means that all prohibitions regarding certain kinds of sales which are mentioned in the *sunna*[7] will be observed if the issue at hand appears to be similar to any of them. The RSB would not generally take into consideration the complexity of many of today's financial transactions and the relative simplicity of corresponding transactions prohibited in the *sunna*. The relevance of these prohibitions to the historical circumstances of the Prophet's time is not generally appreciated in this approach.

b. The emphasis is on examining the issue at hand to see whether it could be brought under one of the contracts or issues prohibited or permitted in *fiqh* [the precedent]. In this comparison, that is between the issue at hand and the precedent, the focus of the RSB generally is on the legal definition of the precedent. If the issue at hand appears to come within the legal definition, then it will take the ruling ascribed to the precedent. Perhaps the most relevant example in this context is interest on loans, which is regarded as *riba*. The legal definition of *riba* as expressed in *fiqh* would cover any conditional increase accruing to the lender over and above a loan.[8] Hence, any loan in which the lender explicitly states that the borrower has to return the principal and an additional amount as interest on loan, would come under the legal definition and would be prohibited. However, some forms of advances which do not have an *explicit* interest element, or where the interest element is not known by the name of interest, would not be regarded as *riba*-based advances, even though they may contain an interest element in a *hidden* form. Apart from the mark-up in *murābaḥa* financing and a higher mark-up for longer periods of repayment in *murābaḥa*, certain other transactions which have an interest element known by a name other than interest, have been permitted. Several examples serve to illustrate this point:

(i) A debt-factoring company undertakes to pay the debts owed to the Islamic bank. When the time of payment comes, and if the debtor does not pay the debt, the company pays it to the bank, and pursues the debt, on condition that the company will charge commission for the debts it collects. This is allowed on the basis that it is an agency contract, and taking fees for agency

[6] Ibid., pp.6-7.
[7] Bukhāri, *Saḥih*, III, pp.195-224.
[8] Saleh, *Unlawful Gain*, pp.35-7.

is allowed.[9] This is despite the fact that the 'commission' in this debt-factoring could be a percentage of the total debts, and that interest rates could feature in determination of this percentage.[10]

(ii) The RSBs have allowed compensation for damages which arise due to the non-payment of a debt to the Islamic bank on time. The view of the RSB of the Jordan Islamic Bank (JIB) is that if a debtor is able to pay, but does not pay his debt to the bank as scheduled, the bank can seek compensation for damages. This, for example, can be inserted as a term in the contract of sale. The amount of compensation can be agreed upon between both parties, or could be determined by arbitration.[11] The similarity between the penalty clause requiring interest for delayed payment in the interest-based system, and the 'compensation' to be paid to the Islamic bank for delayed payment in such a situation, is quite noticeable.

(iii) The RSB of the Kuwait Finance House (KFH) judges that it is lawful to borrow 1,000 dinars, for example, on condition that the borrower later lends (to the first lender) 3,000 dollars for a year.[12] Here a loan is advanced for a certain period of time on an 'interest-free' basis, and the other bank advances a similar amount in a different currency for a similar period of time as a 'compensation'. A reciprocal loan compensates the other bank for the cost of advancing the 'interest-free' loan in the first place. This is similar to the view of the RSB of the JIB in a case where the Islamic bank deposits funds with the interest-based bank on an interest-free basis, and the latter deposits, in future, a similar amount with the Islamic bank, on the same basis, when the Islamic bank is in need of liquidity. The RSB said: "It is lawful."[13]

(iv) The RSB of the KFH permitted the charging of variable 'commission' in a transfer of money[14] and on issuing travellers cheques[15] (as opposed to charging a fixed amount). In another *fatwa* relating to currency exchanges and travellers' cheques, the RSB of the KFH allowed it to charge a percentage of the amount involved as 'fees'.[16]

(v) The Religious Consultant of the International Association of Islamic Banks (IAIB),[17] when asked about giving 'prizes' for savings deposits and current account deposits, said:

[9] KFH, *al-Fatāwa al-Shar'iyya*, I, p.69.
[10] Watson, *Finance of International Trade*, p.173.
[11] JIB, *al-Fatāwa al-Shar'iyya*, II, pp.16-7.
[12] KFH, *al-Fatāwa al-Shar'iyya*, II, pp.191-2.
[13] JIB, *al-Fatāwa al-Shar'iyya*, I, pp.64-7.
[14] KFH, *al-Fatāwa al-Shar'iyya*, II, p.85.
[15] Ibid., pp.92-3.
[16] Ibid., p.107.
[17] Supreme Council for *Fatwa* and *Sharī'a* Supervision.

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[15] Ibid., pp.92-3.
[16] Ibid., p.107.
[17] Supreme Council for *Fatwa* and *Sharī'a* Supervision.

> The bank can give an amount of money each year [to the saving depositors] without making it a condition in the contract.[18]

As for the current account depositors, he said:

> It is lawful to allocate the current account deposit holders within a particular category or any category, some 'prizes' or 'gifts' on condition that it should not be a term of contract [either explicitly or implicitly] when the account was opened.[19]

In all these examples, although there is an interest element, the RSBs have allowed them, presumably because the RSBs' legal definition of *riba* does not cover these forms of 'hidden' interest.

c. The RSBs do not look at the historical differences between what is prohibited in the *sunna* in relation to financial transactions and what appears to be similar to them in contemporary financial dealings. A clear example of this complete disregard of historical differences is the case of gold and silver. In the well known *ḥadīth* on *riba*, the Prophet reportedly prohibited selling gold and silver, except on a hand-to-hand transaction basis, and like for like,[20] which is interpreted by many jurists, as 'equal quantities'. The *'illa* (efficient cause) of prohibition, as advocated by the majority of the jurists, was that both gold and silver were money (*naqdiyya*).[21] Although gold and silver were used as money at the time of the Prophet and throughout Islamic history, they are not used as money today, and neither of them today plays any significant part in the determination of the value of fiat money. The International Monetary Fund (IMF) demonetised gold in 1976, after the collapse of the Bretton Woods agreement in 1971 and the Smithsonian agreement in 1973.[22] Even though most central banks of the world still hold gold as a reserve asset, it does not enter into the determination of the value of money of the countries. The value of a particular currency is determined by a host of factors. Among them are: inflation, interest rate differences between countries, balance of payments, government exchange rate policy, the natural resources of the country, the political stability of the country and even speculation.[23]

Despite the fact that gold and silver are not used as money today, either in the Muslim world or in the world at large, the RSBs generally have ignored this fact so far in their discussion of *riba*. Based on the rules of money exchange in *fiqh*, the RSBs prohibit any gold or silver sales (minted, unminted, or ornaments), which involve deferred delivery of one countervalue. Even the promise to buy gold and silver at a future time is prohibited.[24] This is despite their declaring the lawfulness of deferred delivery of one countervalue in sales of all other precious metals like platinum, and precious stones.[25] In a *fatwa*, the RSB of the KFH said:

> The *sharī'a* has considered gold and silver as money (*athmān*), and there is no difference between minted, bullion, or ornaments. The rules of money exchange should be adhered to, that is, *inter alia*, the exchange should be on a hand to hand transaction basis, and of equal quantity.[26]

Although both gold and silver have been used historically as money, this function has been recently assumed by fiat money. Hence the restrictions on the purchase and sale of gold and silver have in a sense lost their original significance. There is no verse in the Qur'ān to state that gold and silver are to be money forever and in all circumstances. Similarly, there does not seem to be a well-known saying of the Prophet which clearly states that they are to be money regardless of time and place. Hence, it may be safe to conclude that the Prophet's reported instructions with regard to gold and silver and the rules of their exchanging were apparently time-space bound, related to the economic realities of Ḥijāz during the Prophet's time. But since there are *ḥadīth* which give instructions relating to the purchase, sale and exchange of gold and silver, the RSBs are still advocating that the same rules be followed, even though the original reason for the prohibition is no longer apparent.

In money exchange also, the RSBs have taken a strict stand vis-a-vis the delivery of the countervalues. They do not allow money exchange unless the delivery of both countervalues is simultaneous. According to the RSB of the KFH, "the [fiat] money is not gold or silver, but it has taken their place. There are differences among the currencies. The difference among currencies is like the difference between gold and silver. Therefore, one currency can be sold for another on condition that there should be immediate delivery."[27] The same view is expressed in the *fatwas* of the Second Islamic Banking Conference:

> It is not lawful to sell gold, silver, and currency for each other unless delivery is made on the spot. Deferment of one of these would amount to *riba*.[28]

In their *fatwas* on the unlawfulness of money exchange except on an immediate delivery basis, the RSBs are following the literal meaning of the *ḥadīth* without probing into the underlying reason for the Prophet's reported prohi-

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[18] KFH, *al-Fatāwa al-Shar'iyya*, I, p.205.
[19] Ibid., II, p.98.
[20] Bukhāri, *Ṣaḥīh*, III, p.211.
[21] Ibn Qudāma, *Mughni*, IV, pp.5-6.
[22] BPP, *Monetary Economics*, pp.324-6.
[23] Ibid., pp.281-91.
[24] KFH, *al-Fatāwa al-Shar'iyya*, I, p.51.
[25] Ibid., II, pp.28,47,64-5,75.
[26] Ibid., I, p.48. See also the decision of the Supreme Council of 'Ulamā' of Saudi Arabia, No. 10, dated 16-04-1393 AH in KFH, *al-Fatāwa al-Shar'iyya*, I, p.49.
[27] Ibid., II, pp.44-5,84,97.
[28] JIB, *al-Fatāwa al-Shar'iyya*, II, p.51.

bition. As the Ḥanbali scholar, Ibn Qayyim al-Jawziyya (d.751/1350) concluded in his discussion on the underlying reasons for the prohibition of the three basic forms of *riba*,[29] it is the blocking of all means to the pre-Islamic *riba* which was intended in the prohibitions related to money exchange.[30] Also relevant here is that the RSBs are still thinking of the money 'in concrete' (for instance, the gold dinar or silver dirham, or the modern banknote). 'Money', however, is becoming more and more an abstract notion and difficult to define precisely. Central banks generally define 'money' in either a narrow or broad sense. The Bank of England, for instance, has several categories of money: M0, nibM1, M2, M4, M4c and M5. M0 is the narrowest category of money which includes notes and coins in circulation plus banks' till money and their operational balances with the Bank of England. M5 is the broadest category which includes all narrower categories plus holdings by the private sector of money market instruments, certificates of tax deposit and National Savings instruments.[31] Even M5 does not cover all forms of 'money'. According to a governor of the Bank of England, "whatever the boundary drawn between financial assets included and those excluded from a definition of 'broad money', there is likely to be considerable scope for substitution of assets across the dividing line."[32]

d. There is heavy reliance on *ḥadīth*, even though many of these *ḥadīth* on the basis of which a particular transaction is declared unlawful are weak and their authenticity is disputed by prominent scholars. Through reliance on such weak or disputed *ḥadīth*, several transactions in banking and finance are rejected, which may have a negative effect on the future development of some aspects of Islamic banking. Several examples from the *fatwas* highlight this point:

(i) A person sells a commodity at a commodity futures market, to be delivered in future, and the buyer pays a portion of the price at the time of the contract with the balance at a fixed time in the future. This transaction is said to be sale of a debt for a debt (*bay' al kāli' bi al-kāli'*), which is prohibited in *fiqh* and therefore should not be allowed.[33] The *ḥadīth* on which this prohibition is based was narrated by Dār Quṭni (d.385/995) and al-Ḥākim (d.405/1014). Although al-Ḥākim regards it as authentic, Aḥmad b. Ḥanbal does not. In his opinion, Mūsa b. 'Ubayd, the only narrator of the *ḥadīth*, is unreliable and even quoting from him would not be lawful.[34]

(ii) Some RSBs do not allow what is termed as "selling what one does not

[29] *Riba al-faḍl*, *riba al-nasī'a* and *riba al-jāhiliyya*.
[30] Ibn Qayyim, *A'lām al-Muwaqqi'in*, II, pp.154-5.
[31] BPP, *Monetary Economics*, p.22.
[32] Ibid., p.28.
[33] KFH, *al-Fatāwa al-Shar'iyya*, I, p.33.
[34] Shawkāni, *Nayl al-Awṭār*, V, p.156.

own." The example quoted is that a person, *A*, buys a commodity from *B* but before *B* delivers it to *A*, *A* sells it to *C*. According to the RSB of the KFH, there is no difference of opinion among the scholars on the unlawfulness of such a transaction, and it would be a form of *riba*.[35] *Ḥadīth* scholars have differed among themselves on the authenticity of the *ḥadīth* on which this *fatwa* is apparently based, which is, *"lā tabi' mā laysa 'indaka"* (Do not sell what you do not possess). Although Tirmidhi (d.279/893), Nasā'i (d.303/916), Ibn Ḥibbān (d.354/965) and Ibn Ḥajar (d.852/1449) appear to consider it authentic, other scholars do not.[36] The existence of dispute among prominent *ḥadīth* scholars on the authenticity of this *ḥadīth* indicates that its absolute authenticity is not assured. Even if it were, it could not be restricted to one particular interpretation. According to Baghawi (d.516/1122) for instance, this *ḥadīth* does not cover "selling a fully described thing one undertakes to deliver in future."[37] The Shāfi'i jurist Nawawi is more explicit when he says that the prohibition is to be applied when the thing is not in the possession of the person, or if he is unable to deliver it.[38]

(iii) The KFH intends, for instance, to buy a new camera from a company, and stipulates that the company buy an old camera from the KFH. According to the RSB such a transaction is not allowed because it is two sales in one sale.[39] This *fatwa* is seemingly based on the *ḥadīth*, "*man bā'a bay'atayni fī by'atin falahū awkasuhuma aw al-riba*" (Whoever makes two sales in one sale transaction, he should take the lesser of them, otherwise he is taking *riba*). There is no consensus on the authenticity of either the *ḥadīth* itself or its interpretation by Ibn Mas'ūd.[40]

(iv) Any loan which begets an advantage to the lender is said to be *riba*. This is based on the *ḥadīth*, "*kullu qarḍin jarra manfa'atan fa huwa riban*" (Every loan which begets an advantage is *riba*).[41] On the basis of this *ḥadīth*, the RSB of the JIB gave its opinion on the following problem:

The JIB would deposit with an interest-based bank a certain amount on an interest-free basis. An informal agreement between the two banks is then concluded, according to which the interest-based bank would sell to the JIB a certain amount of foreign currency at the rate fixed by the Central Bank on the day of selling. The bank would sell the foreign currency at the buying

[35] KFH, *al-Fatāwa al-Shar'iyya*, I, pp.33-4.
[36] Shawkāni, *Nayl al-Awṭār*, V, p.155.
[37] Ibid.
[38] Ibid.; KFH, *al-Fatāwa al-Shar'iyya*, I, p.35; KFH, *al-Fatāwa al-Shar'iyya*, II, p.49; JIB, *al-Fatāwa al-Shar'iyya*, II, p.36.
[39] KFH, *al-Fatāwa al-Shar'iyya*, II, pp.46, 69-70,78.
[40] Shawkāni, *Nayl al-Awṭār*, V, pp.151-2.
[41] JIB, *al-Fatāwa al-Shar'iyya*, I, p.65.

rate (which is lower than the selling rate). The RSB in its *fatwa* said:

> This form of dealing is a form of loan which attracts an advantage. It is prohibited in the *sharī'a*, and there is consensus of *'ulamā'* on that, especially if the advantage is stipulated. There is no doubt that the bank would not have sold the foreign currency at the buying rate, had the Islamic bank not deposited the money on an interest-free basis.[42]

The *ḥadīth* in question is a *mawqūf ḥadīth*, not a saying of the Prophet. Moreover, the *ḥadīth* is not authentic.[43]

e. At times it appears that there is a tendency on the part of RSBs to solve practical problems by resorting to *ḥiyal* (legal fiction). Even though the RSBs sometimes appear to be averse to *ḥiyal* in their problem solving function,[44] some *fatwas* pronounced by the RSBs of both the KFH and JIB are akin to *ḥiyal*. Utilisation of *ḥiyal* seemingly comes from the RSBs' preoccupation with moulding the solutions which are suggested by the management of the banks, or by the RSBs themselves, into legal forms which are acceptable to various forms of contracts developed in *fiqh*. A solution to a particular problem can be made acceptable if it is in a certain form, while the same solution cannot be acceptable in another form. The RSBs, at times, after declaring a particular transaction unlawful, go on to declare the same transaction lawful if it is presented in a different form even though no modification was made to any of its constituent elements. Such an approach is manifest in a number of *fatwas* of the JIB and the KFH, of which several examples are quoted:

(i) The Islamic bank deposits a certain amount of money with its interest based correspondent bank. As the Islamic bank does not deal on the basis of interest, it suggests to the correspondent bank the following: (i) that the Islamic bank will not earn interest on its deposits; (ii) that the correspondent bank will not charge interest even if the account of the Islamic bank is in debit occasionally; and (iii) that the Islamic bank will maintain a reasonable balance between deposits, withdrawals and overdrafts.[45]

The RSB of the Faisal Islamic Bank of Sudan (FIBS), in its response, judged that any loan which brings upon a benefit is not lawful, as there is agreement among the jurists on this. The RSB suggested another solution to this problem while retaining the substance of the original solution suggested by the management. In line with the RSBs' preoccupation with legal forms of transactions, the solution was put in an acceptable form, from the viewpoint of *fiqh*. The RSB suggested:

> The outlet from this prohibition is that the Faisal Islamic Bank of Sudan deposits funds with the foreign bank [correspondent bank] on an interest free basis, and does not stipulate in the contract that the correspondent bank shall lend to FIBS when its account is in the red. It is enough to agree upon the issue that FIBS shall not pay interest to the correspondent bank when FIBS is in debt to it.[46]

[42] Ibid., pp.85-7.
[43] Shawkāni, *Nayl al-Awṭār*, V, p.232.
[44] KFH, *al-Fatāwa al-Shar'iyya*, I, p.29.
[45] Ibid., p.190.

In this case, the RSB was concerned with the written terms (outward form) of the contract. Although there is an 'understanding' between FIBS and the interest-based bank (an implicit condition), if the condition was not written in the contract, the transaction is deemed to be lawful, according to the RSB. While knowing the intention of the contracting parties, which is to deposit a certain amount for a certain period of time on the understanding that the same amount will be available to the depositing bank in future for a similar period of time, the RSB is overlooking this fact. Without resorting to this legal fiction, examination of the *ḥadīth* on which the 'prohibition' is based, would have revealed that this *ḥadīth*, "*kullu qarḍin jarra manfa'atan fahuwa riban*" is a *mawqūf ḥadīth*, and not a saying of the Prophet. Hence, the *ḥadīth* is not binding.

(ii) In another example, which involved a case where security was to be taken *before* a debt occurred, the RSB of the Kuwait Finance House gave the following opinion:

> It is not lawful to take a pledge before the debt occurs, but there are two alternatives: (i) concluding a contract of sale with the client. After the signing, the client becomes a debtor, and then you may take the security; (ii) including among the terms of sale a condition relating to taking security.[47]

In spite of all the aspects of *taqlīd* manifest in their views on what is acceptable or unacceptable from the *sharī'a* point of view in Islamic banking transactions, the RSBs base some of their *fatwas* on general principles. Some RSBs, for instance, justify the lawfulness of certain transactions on the basis that there is no religious text against them either in the Qur'ān or in the *sunna*.[48] Some *fatwa*s are based on principles, and not particular rulings of *fiqh*.[49] In some of their *fatwa*s, the RSBs resort to the principle that as long as there is no term or condition which makes a prohibited thing lawful, the transaction should be lawful, as a justification for the *fatwa*s.[50] The Seminars of al-Baraka for Islamic Economics (SBIE) expressed the view that "any new contract which is not mentioned in *fiqh* shall be accepted from the *sharī'a* viewpoint as long as it is not in conflict with any *sharī'a* proof from

[46] Ibid., p.192.
[47] Ibid., II, p.191.
[48] JIB, *al-Fatāwa al-Shar'iyya*, I, p.88.
[49] KFH, *al-Fatāwa al-Shar'iyya*, II, pp.88-9.
[50] JIB, *al-Fatāwa al-Shar'iyya*, II, p.20.

the Qur'ān, *sunna*, *ijmā'* or *qiyās*, and which is in the interests of people and does not contain a significant harm."[51] It must be pointed out however, that *fatwas* based on such general principles appear to be relatively few.

Concluding remarks

The foregoing analysis indicates that the Religious Supervisory Board, when determining what is Islamic or otherwise in Islamic banking and finance matters, is highly dependent on Islamic law as developed in the first centuries of Islam, without giving due consideration to the changes that have occurred in the modern period. The RSBs tend to justify their views on the basis of the texts of the Qur'ān or *sunna* (if available) and on views of early jurists. They attempt also to find parallels to modern banking and financial transactions in the *fiqh*, even though these very transactions may have been developed in modern times. In the interpretation of *sharī'a* texts they do not appear to take into consideration the historical relevance of certain transactions which were prohibited. Sufficient consideration is apparently not given to the level of authenticity of some *ḥadīth* which they quote to justify a given transaction.

This approach is characterised by a high degree of legalism and *taqlīd* (imitation) of early jurists and opinions. Such an approach to modern banking and finance transactions does not appear to be justified since the *sharī'a* did not restrict the development of commercial institutions explicitly or implicitly but left it to Muslims to develop such institutions as the circumstances dictated, as long as there was no violation of an explicit *sharī'a* rule as will be discussed in the following chapter.

[51] Ibid., p.25.

CHAPTER EIGHT

ISLAMICITY OF ISLAMIC BANKING: RIBA AND IJTIHĀD

This chapter is a critique of the prevailing neo-Revivalist interpretation of *riba* and its method of determining the islamicity of Islamic banking. The first section looks critically at the neo-Revivalist interpretation and the second section argues that in matters of banking and finance, Muslims need to look at the issues afresh on the basis of *ijtihād*.

Critique of the neo-Revivalist interpretation of riba

In chapter 3, the issue of the neo-Revivalist interpretation of *riba* was discussed briefly. According to this interpretation, interest is equal to *riba*. The following is a critique of this interpretation but before commencing, it is necessary to state briefly the elements of the "interest is equal to *riba*" view of the neo-Revivalists, which appear to be the following:[1] (i) that it is clearly stated in the Qur'ān that in repaying a loan, only the principal should be returned to the creditor, and therefore, any predetermined increase over and above the principal would be *riba*; (ii) that money is 'sterile'; and (iii) that in order to earn a return one must put the money at risk. The following discussion attempts to show why this view is untenable.

The term 'ru'ūsu amwālikum' cannot be interpreted in the sense of a certain quantity of fiat money. The neo-Revivalist view of *riba* as interest is largely based on the literal interpretation of the Qur'ānic expression, "*wa-'in tubtum fa-lakum ru'ūsu amwālikum*." (If you repent then you are entitled to receive your principal) [chapter 2]. Since the verse specifically mentioned the term *'ru'ūsu amwāl'* (interpreted as 'principal'), neo-Revivalists would argue that there is no scope for allowing any increase over and above the principal in a loan. According to them, 'principal' is also to be taken in the sense of a certain quantity of fiat money.[2]

The term *'ra's al-māl'* is comprised of two nouns, which could be rendered into English as 'principal'. More relevant to an appreciation of what the Qur'ān means by the term 'principal' would perhaps be an examination of what could have constituted 'principal' in a debt obligation in pre-Islamic times in Ḥijāz, more specifically in Mecca and Medina. From the reports

[1] See for instance, Miṣri, *Maṣraf al-Tanmiyat al-Islāmi*; Homoud, *Islamic Banking*; Mawdūdi, *Riba*; Drāz, *Riba*.

[2] Chapra, *Towards a Just Monetary System*, pp. 56-7; Rahman, A. *Banking and Insurance*, pp.7ff.

available in the exegetical literature as well as in the *sunna*, it appears that the 'principal' was, at the Prophet's time, related to either a commodity-money or a commodity in the form of gold, silver, animals, foodstuffs, even armaments. Gold and silver were used as money, but at the same time they were used as commodities. Thus the money used in Ḥijāz was a full-bodied commodity-money, whose value was dependent on its content of gold or silver.

Even if one concurs with the neo-Revivalist view that only the principal is to be returned in paying a loan, there could be problems with regard to what constitutes the principal. The argument that money as used in pre-Islamic as well as the early Islamic times was full-bodied, and not fiat money, would lead one to make a distinction between the principal in a debt in full-bodied money, and the principal in a fiat money debt. In the former case, a similar quantity (one unit of gold in repayment for one unit of gold, for example) would be given, treating it basically as a commodity loan. The payment of one unit of gold of similar gold content, in this example, is exactly what the borrower received in terms of its commodity value, and the same value of the original loan was repaid. On the other hand, a loan in fiat money would be stated in terms of its commodity value at the time the loan was contracted, the commodity value being the purchasing power of the money. Two situations require the principal, in this case, to be restated in different amounts of fiat money: (i) inflation in the economy will lead the principal to be stated in a greater number of fiat money units; and (ii) deflation would lead the principal to be stated in a lesser number of fiat money units. When there is no inflation or deflation the principal will be in the same quantity of fiat money units.

This analysis indicates that the term 'principal' (*ru'ūsu amwāl*) is not synonymous with an absolute numerical value in a fiat money loan. Its meaning is related to the nature of the object of the loan. A commodity loan would necessitate the return of an equal amount of the same commodity, while a fiat money loan would be stated in terms of its purchasing power which is its commodity value.[3] It depends on the existence or non-existence of inflation or deflation.

The interpretation does not take into account the nature of riba practised in Ḥijāz at the time of Qur'ānic prohibition. It has been mentioned that Mecca was a 'commercial' city with extensive trade networks, an idea propagated and spread largely by several orientalists including Lammens and, following on from him, by Watt (1953). But the humble nature of the trade of this so-called 'commercial' city has been indicated by Patricia Crone's (1987) research into the pre-Islamic Meccan trade, using Arab and non-Arab

[3] Dunya, "Taqallubāt al-Quwwat al-Shirā'iyya li al-Nuqūd", pp.32-52; Ishaque, Islamisation in Pakistan", pp.65-92.

sources. Whatever the situation, the economy of Mecca of the early seventh century AD would appear to be a subsistence one by today's standards. This does not deny the fact that there were rich people in Mecca as evidenced in Qur'ānic references and early historical sources.[4] But we are concerned here more with the society as a whole, not just a few rich merchants in a predominantly poor community.

Lending in small subsistence communities has been studied to some extent by Sagant (1983), Pouchepadass (1983) and Galey (1983). Even today, in small villages of India for instance, the usurer lends to the poor in the village by taking their land or other possessions as security, often at such absurdly high rates that the borrower in most cases is unable to repay and finding no way out of it, slides into deeper debt. Often this type of lending leads the borrower and his progeny into becoming like slaves to the usurer. The usurer's interest also is not served by a quick repayment of the debt and he ensures that the debt remains unpaid, so that he can continue collecting the interest while at the same time ensuring that the debtor remains under his control.[5] This appears to be somewhat similar to the pre-Islamic *riba* described by early scholars and which has been discussed in chapter 2.

Instead of attempting an appraisal of the historical context in which *riba* was prohibited, neo-Revivalists have been arguing that what is practised today as interest is exactly what was practised in Mecca in the seventh century AD.[6] They reject the thesis of some Modernists who claim that lending in the pre-Islamic period was for consumption purposes, not for investment as happens mostly today. The neo-Revivalist rejection of the Modernist thesis in this regard is based on some contradictory reports mentioned by the well-known exegete, Ṭabari, whose authenticity the neo-Revivalists apparently take as indisputable. As has been mentioned in chapter 2, some of these reports cannot be accepted as historically reliable. Even if all the lending in Mecca in pre-Islamic times was for business purposes, the argument here is not that in Mecca lending and borrowing took place exclusively between a rich usurer and a poor peasant, but that the usurer exacted a high price for his money causing the borrower to default on the loan and plunge deeper into debt. In short, the usurer makes his money from the misery of the debtor irrespective of whether the borrower was originally a rich merchant or a poor peasant. The basic idea is that the more the debtor sinks into debt, the more the usurer demands from him. Avoiding such an injustice, we contend, would be the rationale of prohibition, since there is broad agreement among many jurists on the idea that the *sharī'a* prohibitions in social

[4] Qur'ān 74:11-24; 106:1-4.
[5] Pouchepadass, "Peasant Debt in Colonial Bihar", pp.125-160; Sagant, "Money Lenders and Clan Headman", pp.179-224.
[6] Qaraḍāwi, "Riba al-Bunūk Aswa' min Riba al-Jāhiliyya", pp.61-83.

dealings are either to bring about a benefit or to avoid a harm (injustice).[7]

The argument is partly based on the 'sterility of money' concept. Among the rational arguments advanced against interest by classical as well as some contemporary Muslim scholars, though in a crude form, is that of the 'sterility of money'.[8] This, interestingly, was the crux of the scholastic doctrine of usury in the West and is based on Aristotle's view that 'money is barren'.[9]

Muslim jurists have long regarded money as a 'physical object' or, in other words, money is 'concrete'.[10] Qur'ānic terms used for money such as *'dhahab'* (gold), *'fiḍḍa'* (silver), *'dinar'* and *'dirham'* are concrete.[11] The Prophet reportedly referred to these objects in concrete terms. In the *sharī'a*, gold and silver are regarded as *the* money.[12] Other forms of money were at times even rejected as money proper. Some jurists even indicated that *riba* could not exist in those forms of money as they did not have the quality of *'naqdiyya'* (the characteristic of 'money', regarded as gold or silver).[13]

Aristotle, whose view on money had a significant impact on the usury doctrine of the scholastics in the West, also regarded money as a physical object. Having explained why it came to be invented, he proceeded to describe its required physical properties: it must be made of metal, portable, easy to handle, with a stamp of the amount impressed on it. Whenever Aristotle speaks of money he speaks of 'coin' and his theory of usury was based on the conception of money as coin.[14] Just as the conception of 'money' as an abstract claim was foreign to the Aristotelian concept, so it was foreign to that of the early Muslim jurists.[15] Money in the abstract, as a claim, a right, a power, is not an Aristotelian idea but a legal idea. In the West, this idea of money came to scholastic thought from Roman law partly through canon law, and it eventually contributed strongly to the overthrow of the usury theory of the scholastics, sterility and all.[16]

This sterility concept of money was to some extent based on the ownership of concrete coins. To lend a horse, for instance, was a *locatio*, a contract where ownership does not pass to the borrower. The owner of the horse should simply receive payment for the use of his property, which was regarded as just. Lending money for its normal purpose was a contract of

[7] Khallāf, *Maṣādir al-Tasharī' al-Islāmi*, pp.118,129ff.
[8] Miṣrī, *Maṣraf al-Tanmiyat al-Islāmi*, pp. 177-181.
[9] Langholm, *The Aristotelian Analysis of Usury*, pp.5, 11.
[10] Qaraḍāwi, *Fiqh al-Zakāt*, I, p.239.
[11] Qur'ān 3:14,75; 9:34; 12:20.
[12] Qaraḍāwi, *Fiqh al-Zakāt*, I, p.239.
[13] Jazīri, *Fiqh*, II, p.272.
[14] Langholm, *The Aristotelian Analysis of Usury*, p.60.
[15] Money as an abstract measure was also at best secondary to it. It was influenced by a focus on the function which money in the concrete is first and foremost designed to serve, namely to be a *means of exchange*.
[16] Ibid.,

mutuum, where ownership passes and the money becomes the property of the borrower. It was regarded therefore as unjust that the lender should reap a profit from someone else's property. The contract of *mutuum* was restricted to fungibles, where repayment can be made not in the very objects lent but in equivalent objects of the same species, in the same kind and quantity.[17]

One reason why ownership was considered important was that it was normally accompanied by risk. Some scholastics argued that, while it is permitted to lease a horse or a house, money may not be lent at a profit for four reasons: that ownership of the coins passes;[18] that the risk of harm or loss occurring to the concrete objects borrowed passes;[19] that money does not deteriorate and that it is barren.[20] The retort which presumably springs most readily to the modern mind concerning the scholastic ownership argument against usury, is that it must involve a confusion between ownership of certain pieces of coin and ownership of a certain sum of money in the abstract. It is for the right to use this sum, representing general purchasing power, that the borrower pays interest. The medieval mind was firmly fixed on money in the concrete, and scholastic usury theory was influenced by this fixation.[21] In the post-scholastic tradition, this would be the end of the whole argument. The right to the use of money is a property right of the lender's, and if it commands a price, it is therefore his to sell. As to the idea of the sterility of money, it does not rest on any specific Qur'ānic text or an explicit authentic *sunna* of the Prophet. At best it is an inference from the interpretation of *riba* in the *sharī'a*. It must be noted that money as a claim, a right and power has not yet been accepted explicitly in the *sharī'a*.

Risk is not particularly encouraged. Risk-taking would not be questionable in the case of an entrepreneur, but a small saver may not be willing to jeopardise his hard earned savings in a risk-taking exercise. Since many institutions today are predisposed to specialisation in all areas of social activity, the savings are entrusted to a financial institution which can guarantee them, as well as a return on this capital, which is the result of the provision of savings as loans to the subsequent investors. There is a definite line between the saver and the investor, and the bank is the intermediary between

[17] Ibid., p.75.
[18] If a house or a horse is lent, ownership remains with the lender, and the risk follows ownership. If the house burns, or the horse dies, the loss is the owner's (that is, the lender's). But if money (or anything else thus loanable) is lent in *mutuum*, ownership passes and what happens to the money or the goods bought with it is of no concern to the lender. He can ask for his money back in any case, and to demand a risk premium in addition seems like a double payment. Ibid., p.79.
[19] Here, risk does not mean risk of default, but risk of harm or loss occurring to the concrete objects borrowed, that is, in case of money, to the coins themselves or to the objects bought with the coins.
[20] Ibid., p.78.
[21] Ibid., p.80.

them.

Islamic bankers would argue according to the maxim of Islamic banking, *'al-ghunm bi al-ghurm'* (gain is the result of risk-taking), that the saver is not entitled to a return on his savings unless he puts them *at risk*. But the question is: 'Does Islam glorify risk to the extent the Islamic bankers tend to argue?' If institutional arrangements are such that the saver can earn a return without taking a risk, should he take that risk? For instance, if the government establishes an insurance commission to insure all deposits of banks, must the saver take the risk to earn a return on his savings? Furthermore, if the government guarantees, say, a ten percent return on savings irrespective of what happens to the bank, should the depositor put his savings at risk to get the same return from another bank?

That Islam extols risk is debatable. Mere allowing of *bay'* (sale) does not in itself extol risk, for *bay'* can be conducted without risk; a clear example of this is *murābaḥa*, which is the cornerstone of Islamic banking in practice. At the retail and wholesale level, *bay'* can be conducted on a relatively risk-free basis. There are many lawful contracts under which one party gains a predetermined return without taking a risk. Wages is a good example. In fact, wages must be predetermined. Rent is a predetermined return, and the owner does not have to take a risk to get his return.[22]

In fact, the general tenor of many Qur'ānic verses appears to be in favour of leading the person from the uncertainties of life to the greatest level of certainty. Looking at measures which the Qur'ān takes to protect the person from uncertainties related to his life, wealth and honour, and the severe punishments imposed to protect them[23] gives the idea that Islam is aiming to help the person lead a life relatively free from anxiety. Even the whole concept of *al-qaḍā' wa al-qadar* (divine will and decree) could be taken to mean that it is helping a person to minimise his or her anxiety about future catastrophic events such as failure to achieve a particular goal, or even loss of life. If such things are predetermined by God, then there should be no anxiety about the future. The concepts of *tawakkul* (reliance on God), *ṣabr* (perseverance) and *shukr* (gratitude), for instance, help towards realising the person's peace of mind. Indeed the term *'muṭma'inn'* (tranquil) has been used in the Qur'ān[24] to describe the nature of the believer. Lastly, the *ḥadīth* on which the maxim "*al-ghunm bi al-ghurm*" appears to be based is "*al-kharāj bi al-ḍamān*", which is not a *mutawātir ḥadīth*, and hence does not indicate certainty of knowledge (*al-'ilm al-qaṭ'i*).[25] If a large number of social dealings are prohibited on the basis of such a *ḥadīth*, whose authenticity is not of the highest category, it may perhaps tend to create more problems

[22] Ibn Qudāma, *Mughni*, V, pp.443ff.
[23] Qur'ān 2:179; 5:38; 24:2.
[24] Qur'ān 89:27.
[25] Sha'bān, *Uṣūl al-Fiqh al-Islāmi*, p.62

than benefits for the Muslim community. On the basis of the above, it could be said that taking risks is not particularly extolled in the Qur'ān or in the *sunna*. Allowing some transactions like *bay'* does not in itself indicate any extolling of the 'virtue of risk taking'.

The 'justice' advocated by the neo-Revivalists appears to be one-sided. It is ironic that the 'justice' to which the neo-Revivalist Islamic economists and bankers are referring in relation to *riba* is very one-sided. It invariably refers to the 'weak' entrepreneur who does not know the future but is burdened with paying the capital provider a fixed return on the sum borrowed. This payment to the creditor, while the debtor faces an uncertain future as to the amount of profit he is going to make, is seen to be an injustice to him.[26] It is not appreciated that the entrepreneur of today is working under very different economic and financial conditions than the entrepreneur of early Islamic history. It is true that the investor is uncertain as to how much profit he is going to make after the production of his goods. Today, however, the investor enters into a certain business activity after having calculated his expected rate of profit. If his calculation shows a loss, he would not enter into the activity in the first place. What makes his entry into the business activity possible is his expectation that he can make a profit after all remuneration is paid for all other factors of production.

The neo-Revivalist sympathy for this 'weak' entrepreneur however, is not generally expressed when the depositors of the Islamic banks are referred to. The depositors have to share in the profit or loss of the bank in order to earn any return. Even the loss of value of the purchasing power of their small savings held with the Islamic bank is not to be compensated for, for such would be *riba*, and an injustice against the debtor (in this case the bank).[27] It has not been appreciated that many depositors in the banks are small savers whose savings may be for use in old age when the saver is unable to work, for contingencies such as illness, or for posterity to support them. Hence, the need to keep the savings in a perhaps risk-free deposit account.

Islamic law does not have a well-developed mechanism for loans for non-humanitarian purposes. Loan (*qarḍ*), in Islamic law, has almost invariably been regarded as a means of providing assistance to fellow Muslims. The borrower is viewed as a person in dire need. Ibn Raslān (d.844/1440) says: "The reward of *qarḍ* is better than that of *ṣadaqa* (charity) since no one borrows unless he is in need."[28] Almost all verses of the Qur'ān which refer to *qarḍ* do so in the sense of *qarḍ ḥasan*, which is basically to alleviate the need of the poor. The *sunna*, almost invariably, refers to *qarḍ* as something between the relatively rich and those in need; the former providing the *qarḍ* to

[26] CII, *Consolidated Recommendations*, p.8.
[27] Chapra, *Towards a Just Monetary System*, pp.40-1.
[28] Shawkāni, *Nayl al-Awṭār*, V, pp.229-30.

the latter.[29] Since *qarḍ* is seen to be an institution like *ṣadaqa* (charity), it is highly encouraged. Many *ḥadīth* are attributed to the Prophet indicating the merit of *qarḍ*. One such *ḥadīth* says: "The reward of *ṣadaqa* is equal to ten times, and that of *qarḍ* is eighteen times."[30]

On the other hand, the Prophet reportedly discouraged Muslims from involving themselves in debt, unless absolutely necessary. 'Ā'isha, the Prophet's wife, reportedly said that the Prophet used to pray to God saying: "O Allah, I seek refuge with you from all sins and from debt."[31] Even if one becomes a debtor, he is urged to pay the debt quickly, without delay, particularly if he has the means to do so: "The delay of the rich [in the payment of a debt] is an injustice." In another *ḥadīth* the Prophet reportedly said: "The delay in the payment of debt by one who can afford to pay, justifies his defamation and punishment."[32]

To relieve a person from the pressure of debts, the Prophet asked Muslims to give him *ṣadaqa*.[33] One of the recipients of *zakāt* is the debtor.[34] The Qur'ān asks Muslims not to put an extra burden on the debtor by increasing the debt but to give him extra time. It exhorted them even to forgo the whole debt, and to expect the reward from God in the Hereafter.[35] All these indicate that loans were mainly meant for alleviating personal distress, and that borrowing was highly discouraged unless the borrower was in real need. If one somehow is involved in debts, then, relieving the burden of the debtor is encouraged in the Qur'ān and *sunna*. Borrowing on a large scale by businesses as well as by consumers, as happens in today's societies, is quite foreign to the concept of *qarḍ* as it has been developed in Islamic law.

An interesting point is that in paying debts the Prophet encouraged his followers to pay more than the debt, and in fact many *ḥadīth* specifically state that the Prophet himself did so. In one such case, a creditor of the Prophet came to him and demanded his camel in repayment. The Prophet ordered that he be paid with a better camel (that is, an older one), and said: "The best amongst the people is he who repays his debts in the best manner."[36] In another *ḥadīth*, one of the Companions of the Prophet, Jābir (d.78/697), said that the Prophet repaid a debt owed to him with an increase.[37] Nevertheless, this point was not developed further in Islamic law to facilitate non-humanitarian loans or to develop mechanisms to compensate the lender for such purposes, apparently due to the pervasive influence of the strict interpretation of *riba*.

[29] Bukhāri, *Saḥīḥ*, III, pp.335ff.
[30] Shawkāni, *Nayl al-Awṭār*, V, p.229.
[31] Bukhāri, *Saḥīḥ*, III, p.342.
[32] Ibid., p.343.
[33] Shawkāni, *Nayl al-Awṭār*, V, p.241.
[34] Qur'ān 9:60.
[35] Qur'ān 2:280.
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The point is that the concept of *qarḍ* in Islamic law is inadequate to deal with loans for non-humanitarian purposes. Over the past fourteen centuries, the concept of *qarḍ* has remained in Islamic law as a benevolent act, to alleviate such things as personal distress. Since no adequate mechanism existed to provide loans apart from those for humanitarian purposes, people who needed a loan for non-humanitarian purposes had to resort to *ḥiyal* in order to borrow, apparently at absurdly high rates of interest.[38] In today's economic and financial environment where lending/borrowing are so extensively practised and from which there is no escape, the issue is not to close the door in the face of the loan but to find adequate mechanisms to practise lending on an equitable and just basis, rather than to resort to various stratagems as has been done in the past and is still being done currently.

The above discussion indicates that there are serious flaws in the neo-Revivalist view that interest is *riba*. This issue requires a fresh look by concerned Muslim economists, bankers, financiers, sociologists, and the *'ulamā'* who are capable of understanding the broad *sharī'a* aims and objectives concerning social dealings. The issue of interpretation does not remain only with the *'ulamā'*, since it is not just an interpretation of a scriptural text but an issue which has ramifications for considerable areas of social activity. According to the Qur'ān (16:43), every issue needs to be referred to the specialists who have expert knowledge (*"fa is'alu ahl al-dhikri in kuntum lā ta'lamūn"*). Since the *'ulamā'* are not generally specialists in such areas as banking, finance, economics or international relations, the issue needs to be tackled jointly by the specialists in these areas with experts in the *sharī'a* to arrive at a decision which would be in conformity with the broad *sharī'a* objective of justice. It cannot be solved only by looking at a few *sharī'a* texts and the views of some early jurists, since the circumstances and conditions have changed dramatically and, moreover, they are still changing. Mere declaration of a practice as *ḥarām* (unlawful) is not enough because social forces are so strong that pretending that there is no problem may only serve to exacerbate it, since, out of necessity or adventurism, the so-called *ḥarām* will become widespread, and people will be obliged to act in this way, albeit reluctantly. The Muslim *umma* is facing a critical period in its survival, and there are serious issues to be tackled in order to maintain the relevance of Islam to both the modern intellectual and the laity alike in today's rapidly changing environment. Such issues cannot be tackled by resort to stratagems. In the following, arguments are raised in support of exercising fresh *ijtihād* in determining the islamicity of Islamic banking.

[38] This is based on the figures used in examples of *riba*-related *ḥiyal*. See for instance, Khaṣṣāf, *Ḥiyal*.

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Determining the islamicity of banking practices and activities

The approach of the Religious Supervisory Boards (RSBs) in ensuring the islamicity of Islamic banking, which we have discussed at length in chapter 7, has been criticised by several scholars. The main criticism is that the RSBs approach Islamic banking problems from the point of view of *taqlīd* (imitation), rather than *ijtihād*. Commenting on some *fatwa*s of the RSB of the KFH, the religious consultant of the International Association of Islamic Banks, Majd al-Dīn 'Azzām, says:

> We find that the Religious Consultant [of the Kuwait Finance House] has answered these questions within the limits of views of various schools of law, imitating them.[39]

The following points are advanced as a case for fresh *ijtihād* in order to determine which activity, transaction, service or contract is Islamic, and which is not.

The sharī'a did not inhibit the development of commercial institutions. Textual as well as historical evidence suggests that the Qur'ān and the *sunna* did not inhibit the development of commercial institutions or trade. Qur'ānic references to such institutions are rare and, even where they exist, their aims appear to be fundamentally to ensure that broad *sharī'a* principles, such as justice and fairness, are adhered to. This is apparently the case where *riba*, debts, documentation of debt obligations, and giving full measure in commercial transactions, are mentioned in the Qur'ān.[40] There are no details on how various forms of sale are to be undertaken, nor other forms of trade to be conducted. The lack of detailed laws in the Qur'ān on how to conduct commercial institutions indicates that it gave them sufficient latitude to develop within the overall guidance of the broad principles and the few specific rulings it provided. The Prophet, in his turn, does not seem to have followed a different method. Where he found any violations of the broad *sharī'a* principles like justice and fairness, he prohibited them, but on the whole left the commercial institutions to follow their course of development within the parameters of the *sharī'a*.[41]

Imposing unnecessary constraints in the face of the development of commercial institutions is not in line with Qur'ānic commandments. The increase in unnecessary constraints in the face of development, which are not ordered by God, does not appear to be in line with Qur'ānic commandments. The rationale of the prohibition of various things is given in the Qur'ān as

[39] KFH, *al-Fatāwa al-Shar'iyya*, I, p.114.
[40] Qur'ān 2:275,282; 7:85; 17:35.
[41] The contracts which were developed in the early period of Islamic legal history, were partly developed by the jurists on the basis of the customary practice, although they were at a later stage justified on the basis of some *Shari'a* texts.

follows:

> The Prophet enjoins upon them the doing of what is right and forbids them the doing of what is wrong, and makes lawful to them the good things of life and forbids them the bad things.[42]

Again, in another verse the Qur'ān says:

> They ask you [the Prophet] as to what is lawful to them. Say, 'Lawful to you are all the good things of life'.[43]

What is lawful is described as 'good' in several verses of the Qur'ān.[44] A clear definition of what is 'good' is given neither in the Qur'ān nor in the *sunna*, presumably leaving sufficient freedom to the believers to determine these matters in the light of the overall guidance given in the two foundational texts. Having declared that it is the bad things which are prohibited, the Qur'ān strongly reproaches those who hasten to declare things as lawful (*ḥalāl*) and unlawful (*ḥarām*). The Qur'ān says:

> Hence, do not utter falsehoods by letting your tongues determine [at your own discretion], "This is lawful and that is forbidden", thus attributing your own lying inventions to God.[45]

In another verse, the Qur'ān says:

> Have you ever considered all the means of sustenance which God has bestowed upon you from on high, and which you thereupon divide into 'things forbidden' and 'things lawful'? Say: "Has God given you leave [to do this], or do you, perchance, attribute your own guesswork to God?"[46]

Regarding this verse, Muhammad Asad, a contemporary commentator on the Qur'ān, says:

> In accordance with the doctrine that everything which has not been expressly forbidden by the Qur'ān or the explicit teachings of the Prophet is *eo ipso* lawful, this verse takes a clear-cut stand against all arbitrary prohibitions invented by man or artificially 'deduced' from the Qur'ān or the Prophet's *sunna*.[47]

In another verse, the Qur'ān clearly prohibits the believers from forbidding what God has made lawful.[48] Even the Prophet was severely reprimanded for doing so:

> O Prophet! Why do you, out of a desire to please [one or another of] your

[42] Qur'ān 7:157.
[43] Qur'ān 5:4.
[44] Qur'ān 2:168; 5:88; 16:114.
[45] Qur'ān 16:116.
[46] Qur'ān 10:59.
[47] Asad, *The Message*, p.300. See note 81 in p.300. For the original reference of Asad see Riḍa, *Manār*, II, pp.409 ff.
[48] Qur'ān 5:87.

> wives, impose [on yourself] a prohibition of something that God has made lawful to you?[49]

In another verse the Qur'ān says:

> Who is there to forbid the beauty which God has brought forth for His creatures, and the good things from among the means of sustenance?[50]

The Qur'ān and *sunna* apparently do not envisage any difference between prohibiting a lawful thing, and making lawful a prohibited thing. It is perhaps for this reason that early jurists like Abu Yūsuf in their *fatwas* "avoid the use of the terms *ḥalāl* and *ḥarām*, except for matters permitted or prohibited categorically in the Qur'ān."[51] According to Abu Yūsuf, he found that his teachers disliked the practice of saying in their legal decisions "This is *ḥalāl* and this is *ḥarām*" except for what was mentioned expressly in the Qur'ān as such without any qualification.[52] Another important point related to this is that extra-Qur'ānic and extra-prophetic prohibitions act as constraints, which in many cases people are not able to abide by, thus creating a gulf between theory and practice. To bridge this gap, the need arises to invent stratagems (*ḥiyal*).

Views expressed by early jurists cannot answer all modern banking and finance problems. Commercial institutions and contracts developed in the traditional *fiqh* cannot provide answers for all contemporary highly complex banking and financial matters. This is due to the large gap between the commercial institutions and contracts discussed in the traditional *fiqh*, and those which have been developed and are being developed in the modern period. The most creative period of the development of *fiqh* goes back to the first four centuries of Islam, after which a gradual stagnation of the creative process of *ijtihād* began to take place. From the fifth and sixth centuries AH onwards, the doctrine of closure of the "gate of *ijtihād*" was accepted by many jurists. Hence the creativity of many jurists became restricted to the explanation and limited interpretation of earlier jurists' views. The emphasis on fresh *ijtihād* which was so characteristic of the formative period of *fiqh* was replaced by *taqlīd*, hindering the development of law in line with the developments in society.[53]

Ever changing commercial and economic institutions have brought innumerable and totally novel problems to which answers are not available in the traditional *fiqh*. For this very reason, one might be justified in accepting the need for exercising fresh *ijtihād*, on the basis of the principles and explicit rulings of the Qur'ān and *sunna*, in order to find Islamic solutions

[49] Qur'ān 66:1.
[50] Qur'ān 7:32.
[51] Hasan, *The Early Development* p.35.
[52] Ibid.
[53] Husaini, *Islamic Environmental Systems*, pp.18-9.

to the emerging problems, rather than attempting to find a view of an early jurist on an issue which appears to be similar to a modern financial transaction. Since the ever developing banking and finance methods are by definition new, and, hence, did not exist in the time of the revelation, such transactions need constantly to be looked at from the points of view of broad *sharī'a* principles of justice, equity, fairness, and compassion.

Changes of rules appear to have been recognised in the Qur'ān and sunna and by the earliest leading authorities of Islam. Perhaps we must also take into account that there is a distinction between what is prohibited clearly and unambiguously in the Qur'ān and *sunna*, and is meant to be prohibited for all times and places, and that which is generally prohibited on the basis of *ijtihād*. Scholars like Husaini (1980) would argue that ordinances which are to remain unchanged

> either cover only general principles or provide detailed legislation on issues which, being rooted in the basic elements of human nature are independent of sociological and technological factors.[54]

It is perhaps these principles which remain permanent irrespective of time and space, and, admittedly, they are few and flexible.[55] Much of the detailed laws developed by Muslim scholars on the basis of the Qur'ān and *sunna* as well as *qiyās* and *ijmā'* perhaps do not fall into this category. This body of law was the outcome of various deductive and inductive methods of reasoning, and these rulings are apparently 'dependent on the social, material, and intellectual environments of each age and polity; they comprise temporal legislation.'[56] Muhammad Asad, a modern commentator on the Qur'ān, in his interpretation of the verse 5:101 remarked:

> Some of the greatest Muslim scholars have concluded that Islamic Law, in its entirety, consists of no more than the clear-cut injunctions forthcoming from the self-evident (*ẓāhir*) wording of the Qur'ān and the Prophet's commandments, and that, consequently, it is not permissible to extend the scope of such self-evident ordinances by means of subjective methods of deduction. This, of course, does not prevent the Muslim community from evolving, whenever necessary, any amount of additional, temporal legislation in accordance with the spirit of the Qur'ān and the teaching of the Prophet: but it must be clearly understood that such additional legislation cannot be regarded as forming part of Islamic Law (*sharī'a*) as such.[57]

Such a view, however, is not shared by the most influential neo-Revivalist movements of the twentieth century. Mawdūdi (d.1979) regarded *sharī'a* as "the detailed code of conduct or the canons comprising ways and modes of

[54] Ibid., p.16.
[55] This is perhaps a reaction to the neo-Revivalists' overemphasis on the permanence of rulings arrived at by early jurists on the basis of the Qur'ān and *sunna*.
[56] Ibid.,
[57] Asad, *The Message*, p.165.

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In another verse the Qur'ān says:

> Who is there to forbid the beauty which God has brought forth for His creatures, and the good things from among the means of sustenance?[50]

The Qur'ān and *sunna* apparently do not envisage any difference between prohibiting a lawful thing, and making lawful a prohibited thing. It is perhaps for this reason that early jurists like Abu Yūsuf in their *fatwas* "avoid the use of the terms *ḥalāl* and *ḥarām*, except for matters permitted or prohibited categorically in the Qur'ān."[51] According to Abu Yūsuf, he found that his teachers disliked the practice of saying in their legal decisions "This is *ḥalāl* and this is *ḥarām*" except for what was mentioned expressly in the Qur'ān as such without any qualification.[52] Another important point related to this is that extra-Qur'ānic and extra-prophetic prohibitions act as constraints, which in many cases people are not able to abide by, thus creating a gulf between theory and practice. To bridge this gap, the need arises to invent stratagems (*ḥiyal*).

Views expressed by early jurists cannot answer all modern banking and finance problems. Commercial institutions and contracts developed in the traditional *fiqh* cannot provide answers for all contemporary highly complex banking and financial matters. This is due to the large gap between the commercial institutions and contracts discussed in the traditional *fiqh*, and those which have been developed and are being developed in the modern period. The most creative period of the development of *fiqh* goes back to the first four centuries of Islam, after which a gradual stagnation of the creative process of *ijtihād* began to take place. From the fifth and sixth centuries AH onwards, the doctrine of closure of the "gate of *ijtihād*" was accepted by many jurists. Hence the creativity of many jurists became restricted to the explanation and limited interpretation of earlier jurists' views. The emphasis on fresh *ijtihād* which was so characteristic of the formative period of *fiqh* was replaced by *taqlīd*, hindering the development of law in line with the developments in society.[53]

Ever changing commercial and economic institutions have brought innumerable and totally novel problems to which answers are not available in the traditional *fiqh*. For this very reason, one might be justified in accepting the need for exercising fresh *ijtihād*, on the basis of the principles and explicit rulings of the Qur'ān and *sunna*, in order to find Islamic solutions

[49] Qur'ān 66:1.
[50] Qur'ān 7:32.
[51] Hasan, *The Early Development* p.35.
[52] Ibid.
[53] Husaini, *Islamic Environmental Systems*, pp.18-9.

to the emerging problems, rather than attempting to find a view of an early jurist on an issue which appears to be similar to a modern financial transaction. Since the ever developing banking and finance methods are by definition new, and, hence, did not exist in the time of the revelation, such transactions need constantly to be looked at from the points of view of broad *sharī'a* principles of justice, equity, fairness, and compassion.

Changes of rules appear to have been recognised in the Qur'ān and sunna and by the earliest leading authorities of Islam. Perhaps we must also take into account that there is a distinction between what is prohibited clearly and unambiguously in the Qur'ān and *sunna*, and is meant to be prohibited for all times and places, and that which is generally prohibited on the basis of *ijtihād*. Scholars like Husaini (1980) would argue that ordinances which are to remain unchanged

> either cover only general principles or provide detailed legislation on issues which, being rooted in the basic elements of human nature are independent of sociological and technological factors.[54]

It is perhaps these principles which remain permanent irrespective of time and space, and, admittedly, they are few and flexible.[55] Much of the detailed laws developed by Muslim scholars on the basis of the Qur'ān and *sunna* as well as *qiyās* and *ijmā'* perhaps do not fall into this category. This body of law was the outcome of various deductive and inductive methods of reasoning, and these rulings are apparently 'dependent on the social, material, and intellectual environments of each age and polity; they comprise temporal legislation.'[56] Muhammad Asad, a modern commentator on the Qur'ān, in his interpretation of the verse 5:101 remarked:

> Some of the greatest Muslim scholars have concluded that Islamic Law, in its entirety, consists of no more than the clear-cut injunctions forthcoming from the self-evident (*ẓāhir*) wording of the Qur'ān and the Prophet's commandments, and that, consequently, it is not permissible to extend the scope of such self-evident ordinances by means of subjective methods of deduction. This, of course, does not prevent the Muslim community from evolving, whenever necessary, any amount of additional, temporal legislation in accordance with the spirit of the Qur'ān and the teaching of the Prophet: but it must be clearly understood that such additional legislation cannot be regarded as forming part of Islamic Law (*sharī'a*) as such.[57]

Such a view, however, is not shared by the most influential neo-Revivalist movements of the twentieth century. Mawdūdi (d.1979) regarded *sharī'a* as "the detailed code of conduct or the canons comprising ways and modes of

[54] Ibid., p.16.
[55] This is perhaps a reaction to the neo-Revivalists' overemphasis on the permanence of rulings arrived at by early jurists on the basis of the Qur'ān and *sunna*.
[56] Ibid.,
[57] Asad, *The Message*, p.165.

worship, standards of morals and life and laws that allow and proscribe, that judge between right and wrong."[58] For scholars like Mawdūdi, the rules and regulations specified in the Qur'ān and *sunna* would not change according to the time, place and the level of intellectual and technological development of the Muslim community. Once the Qur'ān and *sunna* have a say on any issue, it should be followed to the letter. This appears to be the prevalent view within the Muslim community and among Muslim scholars.

However, the Modernist scholars would argue that one of the characteristics of the primary foundational text of Islam, the Qur'ān, is that it contains, relatively speaking, few specific laws but more standards of conduct and behaviour[59] from which general principles could be deduced.[60] It is perhaps a consequence of the universalistic character of the Qur'ān and of the Prophet's mission that such flexibility should exist. Provision of specific laws which would generally be particularistic perhaps may negate its universalistic character. The dearth of particular laws in the Qur'ān could be appreciated if we look at the number of verses which are legal in character. According to An-Na'im,[61] a Sudanese Islamic scholar, out of 6219 verses of the Qur'ān only about 500 to 600 have a legal connotation, most of which are related to worship, and only about 80 verses deal with strictly legal matters. At times it appears that the Qur'ān was not interested in providing too many laws, in order to give maximum freedom to the believers to conduct their lives. The Qur'ān apparently did not want to put unnecessary hardship on the believers: "God wills that you shall have ease, and does not will you to suffer hardship."[62] In one verse it even encouraged the Muslims not to ask about too many things:

> O those who believe! Do not ask about matters which, if they were to be made manifest to you [in terms of law], might cause you hardship; for if you should ask about them while the Qur'ān is being revealed, they might [indeed] be made manifest to you as laws. God has absolved [you from any obligation] in this respect.[63]

In line with this, most of the 'laws' the Qur'ān communicated in detail, were related to what is termed in the Islamic law as 'worship' (*'ibādāt*). Khallāf, who held rather Modernist views on Islamic law, gives the reason for this as follows:

> In the rules related to worship and analogous matters which are in the category of worship, there is no place for the human mind to decide and their rules do not change due to changes in circumstances. As for the rulings which are not related to worship and associated matters, like that of civil, constitutional, criminal and economic matters which evolve and change according to new circumstances, the Qur'ān did not go into details. It limited itself to expounding only the basic and fundamental principles which do not change according to circumstances.[64]

[58] Mawdūdi, *Towards Understanding Islam*, p.143.
[59] The Qur'ānic commandments and prohibitions generally appear to be moral in character. They generally do not specify the legal consequences of violating these moral standards.
[60] Coulson, *A History of Islamic Law*, pp.11-3.
[61] An-Na'im, *Toward an Islamic Reformation*, p.20.
[62] Qur'ān 2:185.
[63] Qur'ān 5:101.

As for the *sunna* of the Prophet, the second foundational text of Islam, Modernists could argue that it displays the same flexibility which exists in the Qur'ān. One of the key arguments in favour of this view could be that from the earliest period of Islamic legal history, many leading authorities including leading Companions of the Prophet were selective in their following of individual *ḥadīth* texts even if such *ḥadīth* were authentic.

The prevalent view among Muslims is that if a *ḥadīth* exists on an issue then it has to be followed. Many examples exist where several leading authorities, even the Companions of the Prophet, have rejected *ḥadīth* for various reasons.[65] The jurists and even the *imāms* of the schools of law did not accept a *ḥadīth* just because it is sound in terms of its *isnād* (chain of transmission of the *ḥadīth*), particularly in the pre-Shāfi'i period.[66] Shaybāni, for instance, criticised Mālik and the Medinan jurists for their setting aside *ḥadīth* and following "what they like" which is not supported by any *athar* or *sunna*.[67] It was Shāfi'i who advocated that any *ḥadīth*, once its authenticity is established, must be followed literally,[68] a view which came to dominate subsequent Islamic legal thinking. Submission to *ḥadīth*, as Shāfi'i would have put it, became so pervasive in Islamic legal thinking that the idea that wherever there is a *ḥadīth* it must be followed became widely accepted. Such an emphasis, particularly if accompanied by a literal interpretation of *ḥadīth*, would put many obstacles in the way of developing Islamic law in line with developments in society.

Another important feature of the Qur'ān is that it was revealed in a historical context.[69] It was revealed to the Prophet Muḥammad in Ḥijāz over a period of twenty-three years to guide him and the Muslims, and to solve various problems which they faced individually and collectively. Many verses of the Qur'ān were revealed in response to what was happening in the community within which the Prophet was living, as is evidenced by the *asbāb al-nuzūl* (occasion of the revelation) literature[70].

[64] Khallāf, *Maṣādir al-Tashari' al-Islāmi*, p.157.
[65] Sha'bān, *Uṣūl al-Fiqh*, p.68; Shawkāni, *Nayl al-Awṭār*, VI, pp.172-3.
[66] Sha'bān, *Uṣūl al-Fiqh*, pp.70-73.
[67] Hasan, *The Early Development*, p.107.
[68] Ibid., p.181; Shāfi'i, *Umm*, VII, p.242ff.
[69] This is not always appreciated in Islamic tradition apparently due to the theological arguments relating to the doctrine of "speech of God" or "word of God".
[70] For instance, the whole chapter of *al-Nūr* of which a large part deals with the mutual relations of the sexes and with certain ethical rules to be observed in the context of this relationship (Asad, *The Message*, p.532) was revealed in relation to the famous story of *ifk* (lie).

The historical aspect of the Qur'ān, however, has been submerged in the theological debates of the second and third centuries AH, particularly on the issue of whether the Qur'ān was 'created' or 'uncreated'. The Sunnis, led by the Traditionists like Aḥmad b. Ḥanbal, firmly held to the belief that the Qur'ān could not be described as 'created' (*makhlūq*), while the Mu'tazila, a theological sect, held to the belief that the Qur'ān was 'created'.[71] This emphasis of the Sunnis on the uncreatedness of the Qur'ān, among other things, appears to have led to the view that all that is contained in the Qur'ān, including the form of rulings, is eternal. If this is so, then any rulings of the Qur'ān must also have eternal validity. The corollary of this would be that the 'forms' of rulings specified in the Qur'ān must be upheld regardless of time and space. This idea was also supported presumably by several verses which indicate that the religion is perfected and reached the climax of its perfection at the time of the death of the Prophet, as the verse 5:3 is taken to mean.[72] Supporting the historical aspect of the Qur'ān, Ahmad Hasan, a Pakistani scholar, said:

> God did not reveal the Qur'ān in a vacuum, but as a guide to a living Prophet, who was engaged in an actual struggle. The Qur'ān, however, instead of giving the minutiae, indicates basic principles that lead a Muslim in a certain direction, where he can find the answer by his own effort. Moreover, it presents the Islamic ideology in a general form, suited to the changing circumstances in all ages and climes.[73]

Several rules in the Qur'ān and sunna have changed and there is in principle support in these changes to further changes when required. That change can occur and has occurred in the rules stated in the Qur'ān and *sunna* is evident from the following issues.

Public interest and change. One of the most important mechanisms by which changes appear to have been made to the rulings stated in or based on the Qur'ān or the *sunna*, is the *maṣlaḥa* (public interest). According to a contemporary jurist, Khallāf:

> if there is an evidence that what is legislated was on the basis of a special interest related to a specific time, the rule would revolve with that interest; where the interest exists, the rule will apply, and where it does not, the rule will not apply.[74]

If a *sharī'a* text is based on customs and usages, and if the latter changes, Abu Yūsuf, on the basis of the principle of juristic preference, held that "the

[71] *Sharḥ al-'Aqīda al-Ṭaḥāwiyya*, pp.179-203. It is a tenet of belief of Sunnis that the Qur'ān is the Word of God, and hence uncreated.

[72] The verse says: "Today have I perfected your religion for you and have bestowed upon you the full measure of My blessings." Qur'ān 5:3. '*Dīn*' in this verse is taken to mean 'religious law'.

[73] Hasan, *The Early Development*, pp.44-5.

[74] Khallāf, *Maṣādir al-Tasharī' al-Islāmi*, p.164.

text should be discarded in favour of custom in such circumstances. He stressed that custom had been the primary consideration in such rules."[75] According to the jurist Qarāfi (d.685/1286), "all rules in the *sharī'a* that are based upon customs change when customs change, in accordance with the requirements of the new custom."[76]

Rules related to *mu'āmalāt* ('social dealings' or 'transactions'), are generally related to the practices and customs of a particular people, and hence, such rules may be changed as their circumstances evolve. The Ḥanbali jurist Ṭūfi (d.716/1316) in his commentary on the *ḥadīth*, "*lā ḍarara wa lā ḍirāra*", argued that rules in *mu'āmalāt* (social transactions)[77] are based on the interest of people (*maṣlaḥat al-nās)* and said:

> The *maṣlaḥa* [interest] and other remaining *sharī'a* sources [*adillat al-shar'*] either all agree or differ. If they agree it is good...If they differ try to reconcile them...If reconciliation is not possible, then *maṣlaḥa* should be given priority over all other *sharī'a* sources based on the saying of the Prophet, "*lā ḍarara wa lā ḍirāra.*"[78]

The concept of naskh (repeal). The concept of *naskh* developed in *uṣūl al-fiqh*, and accepted by the majority of Sunni schools of law, is another indication that, in the primary sources of the *sharī'a,* there is evidence to suggest that rules have changed in line with differences in time and place. *Naskh* means:

> to supersede or supplant a *shar'i* (legal) rule by means of later *shar'i* (legal) provision with the aim of liberalising the law for the people, making possible progress in legislation in order to adapt the rules governing transactions to the changing times.[79]

The majority of jurists have accepted in principle the validity of the concept of *naskh*, though there are some differences on how and in what way *naskh* can occur. The following are two examples of *naskh* occurring in the Qur'ān and *sunna*. In early Islam, the punishment of adultery was confinement of the woman to the house, and verbal chastisement for the man, based on verses 4:15-6. This was repealed later by the introduction of flogging, each of them receiving one hundred stripes.[80] In another example, the Qur'ān says:

> It is ordained for you, when death approaches any of you and he is leaving

[75] Mahmassani, *Falsafat al-Tashrī' fi al-Islām*, p.115.

[76] Ibid., p.116.

[77] For a detailed discussion of this concept, see Ṭūfi, *Risāla* in Khallāf, *Maṣādir al-Tasharī' al-Islāmi.*

[78] Ibid., p.141. The *maṣlaḥa* cannot be considered in 'worship' and those things similar to 'worship' because it is only the *Shar'* which determines its number, method of performing, time and place.

[79] Mahmassani, *Falsafat al-Tashrī' fi al-Islām*, p.64.

[80] Qur'ān 24:2.

> behind much wealth, to make bequests in favour of his parents and [other] near of kin in accordance with what is fair.[81]

This rule is reportedly repealed by a *sunna* stating that "there is no bequest to any one who is going to inherit."[82]

Early authorities and change of rules. There are cases where some leading Companions, like the second caliph 'Umar b. al-Khaṭṭāb, did in fact categorically state that certain rules were not applicable in his time, and at other times he suspended some Qur'ānic laws. Taken to its logical conclusion this may mean that some laws stated in the Qur'ān and *sunna* were time-specific, and if the reasons for their existence no longer existed the law would not be applicable. The following provides some examples specifically related to 'Umar b. al-Khaṭṭāb, due to the eminent place he enjoys in Islam:

(i) The Qur'ān explicitly stated that *ṣadaqāt (zakāt)* is specifically for the poor and the needy, and those who are in charge thereof, and those whose hearts are to be won over, and for the freeing of human beings from bondage, and for those who are overburdened by debts, and for every struggle in God's cause, and for the wayfarer."[83] At the end of the verse, the Qur'ān says: "This is an ordinance from God." 'Umar b. al-Khaṭṭāb refused to give any share of *zakāt* to "those whose hearts are to be won over" in direct opposition to the explicit Qur'ānic command as well as the practice of the Prophet. This is more noteworthy, since *zakāt* and its distribution is regarded as a form of 'worship' (*'ibādāt*), which, as generally held in the *sharī'a*, cannot be tampered with by anyone except God and the Prophet. 'Umar reasoned that since the verse was revealed at a time when Islam was relatively weak and it needed the support of the new converts who may not be so sincere in their belief, the reason did not exist in his time. As he saw it, Islam, *in his time*, was powerful and was not in need of winning over such insincere converts.[84]

(ii) The Qur'ān explained the method of distribution of booty, and following that, the Prophet in his practice used to distribute the land as booty for the fighters. But 'Umar refused to distribute the lands of Iraq and Syria.[85]

(iii) The Prophet punished the adulterer by exile[86] and the Qur'ānic punishment of 100 lashes. 'Umar suspended the punishment of exile (which is a *sunna*) when a Muslim exile joined the enemies in his reign.[87]

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[81] Qur'ān 2:180.
[82] Shawkāni, *Nayl al-Awṭār*, VI, pp.39-40.
[83] Qur'ān 9:60.
[84] Sharaf al-Din, *Tārikh al-Tashrī' al-Islāmi*, pp.110-1.
[85] Hasan, *The Early Development*, pp.119-20.
[86] Shawkāni, *Nayl al-Awṭār*, VII, pp.73ff.
[87] Mahmassani, *Falsafat al-Tashrī' fi al-Islām*, pp.122-3.

(iv) If a person repudiated his wife three times in one sitting, in the days of the Prophet, it was considered as one divorce. When 'Umar found that people were repudiating their wives in this manner, he punished them by considering three times as three divorces.[88]

(v) The Prophet punished the consumer of alcohol (wine) by forty strokes of the whip. 'Umar increased the punishment to eighty strokes.[89]

(vi) Temporary marriage (*mut'a*) was allowed during the time of the Prophet. 'Umar forbade it.[90]

(vii) The Prophet did not take *zakāt* on horses, but 'Umar began to do so.[91] In all this we find that 'Umar, who is one of the very few Companions with a profound knowledge of the Qur'ān and the methods of the Prophet, did not blindly follow the texts of the Qur'ān and *sunna*, but when conditions changed he also changed the rules.

The following examples indicate that some rules which were based on texts of the Qur'ān or *sunna* were changed by some Companions:[92]

(i) In the days of the Prophet, there was only one *adhān* (call for prayer) for Friday prayer, but 'Uthmān b. 'Affān increased it to two.

(ii) In the days of the Prophet, blood money for a Christian or a Jew was equal to that of a Muslim, and was paid to the family of the victim. However, Mu'āwiya b. Abi Sufyān (d.60/680), the Umayyad caliph, ordered to pay half of the blood money to the Treasury, leaving the other half to the family of the deceased. 'Umar b. 'Abd al-'Azīz (d.101/720) cancelled the share of Treasury, and retained Mu'āwiya's rule of one-half for the family.[93]

(iii) The Qur'ān allowed followers to perform *tayammum* (a special form of ablution) in case of illness or the unavailability of water. It is also claimed that the Companions had consensus on this issue. But the Companion Ibn Mas'ūd disagreed and considered that it should not be allowed, saying: "If we allowed for them in this (*rakhkhaṣna lahum fī hādha*) the result could be that if someone feels that the water is cold, he would rather perform *tayammum* instead of ablution (*wuḍū'*), even though water is available." Even when Abu Mūsa al-Ash'ari (d.42/663) contradicted him by quoting the verse and the *ḥadīth* of 'Ammār b. Yāsir (d.37/657), Ibn Mas'ūd disregarded it.[94]

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[88] Shawkāni, *Nayl al-Awṭār*, VI, p.230.
[89] Suyūṭi, *Tārikh al-Khulafā'*, p.137.
[90] Ibid.
[91] Ibid.
[92] Some of the following is based on Mahmassani, *Falsafat al-Tashrī'*, pp.114-7 .
[93] Ibid., p.114.
[94] Khallāf, *Maṣādir al-Tashrī'*, p.128, 133.

The foregoing indicates that the earliest Muslims did not follow the texts of the Qur'ān and *sunna* literally without considering the changing circumstances. Where they found that interest warranted changing some rules, they changed them. Some of these changes would appear to be somewhat shocking to some Muslims as the case of 'Umar and the *zakāt* issue indicates.

Ijmā' on a rule does not necessarily mean that the rule cannot be changed. According to the scholars of the principles of jurisprudence, *ijmā'* (consensus) is the third source of the *sharī'a*. It is defined as "consensus of the *mujtahids* of the *umma* on a legal point, after the death of the Prophet."[95] There is, however, no consensus among the jurists on what *ijmā'* is, or the extent of its authority. Among the Sunnis, Mālik regarded *ijmā'* of the people of Medina as *the ijmā'*. Aḥmad b. Ḥanbal and the Ẓāhiris regarded *ijmā'* of the Companions as proper *ijmā'*.[96] For Shāfi'i, *ijmā'* of the *umma* is proper *ijmā'*.[97] On the other hand, Naẓẓām (d.230/845), the Mu'tazili theologian, the Khārijis and Shī'is believe that *ijmā'* is not a *sharī'a* source.[98] Even among those who believe in an *ijmā'* as defined above, there are differences on whether it can be explicit (*qawli*) or implicit (*sukūti*). The former is "agreement of all *mujtahids* in a certain period on a legal issue by expressing, each of them, his view explicitly."[99] This is the proper *ijmā'* according to those who believe in it. Where *ijmā'* is evidenced by the silent assent of the *mujtahids*, this is implicit. There are serious disputes on whether it can be regarded as proper *ijmā'*.[100] Another issue of relevance is whether *ijmā'* of one generation is binding on later generations. Again there is no agreement on this issue. A middle ground was held by some who said that *ijmā'* of the Companions is binding on all generations.[101] The question here is, 'Do the Companions enjoy a special form of authority similar to that of the Qur'ān or the Prophet.' Neither the Qur'ān nor the *sunna* explicitly gives them such authority. If anything, the Qur'ān provides us with sufficient examples of fallibility inherent in every human being including the Companions of the Prophet.[102]

On examination of *ijmā'* as expounded in *uṣūl al-fiqh* works, it appears that many fundamental issues relating to the concept are not satisfactorily resolved, such as, who is the *mujtahid*, who can be a member of this *ijmā'*, how many members there should be, the meaning of "*all mujtahids*" in the definition, how it can be done, and whether the *mujtahids* should be from all

95 Rahim, *The Principles of Muhammadan Jurisprudence*, p.115.
96 Hasan, *The Early Development*, p.156.
97 Shāfi'i, *al-Risāla*, pp.285-7.
98 Rahim, *The Principles of Muhammadan Jurisprudence*, p.117.
99 Sha'bān, *Uṣūl al-Fiqh*, p.90.
100 Ibid.
101 Rahim, *The Principles of Muhammadan Jurisprudence*, pp.122-30.
102 Qur'ān 21:87;20:116-121;9:38-9.

schools of law, Sunni and Shī'i.[103] It is doubtful that *ijmā'*, if it ever occurred as indicated in the definition, can be on anything but the most fundamental issues of the religion like the unity of God, the prophethood of Muḥammad, and the five pillars of Islam. Even with regard to the *ijmā'* reported in the literature as *ijmā'* of the Companions, one would be sceptical as to whether it is the consensus of all *mujtahids* among the Companions or that of a few Companions residing in Medina, the capital. It is well established that all leading Companions did not reside in Medina after the death of the Prophet, and particularly after the Muslim conquests began in the time of the first caliph Abu Bakr. Apart from a few leading Companions, all others were either engaged in fighting or had settled in newly conquered regions. Hence, even in the time of Abu Bakr and 'Umar, the convention of *ijmā'*, as the later theory holds, would be unlikely. Where *ijmā'* on an issue is reported, it appears to be mainly the view of a few Companions, described by Bello as 'elitist'.[104] Any opposition to the cases which otherwise may have been in existence is either not mentioned or neglected in the course of the recording of the *sharī'a* sciences which went on in the first three centuries of Islam. Many *ijmā'* are reported in the books of *fiqh*. At the same time there are differences on these very issues on which *ijmā'* has been claimed, either by other schools of law or by some leading *mujtahids*. This shows that either the definition of *ijmā'* is defective or it is only a theoretical concept.[105]

Form or spirit. It appears from Qur'ānic references as well as reported incidents from the Prophet's lifetime that the emphasis was on "the value and spirit of the action and not the form of the action itself."[106] The Qur'ān says: "True piety does not consist in turning your faces towards the east or the west."[107] According to Asad, "the Qur'ān stresses the principle that mere compliance with outward forms does not fulfil the requirements of piety."[108] In another verse, the Qur'ān says: "Piety does not consist in your entering houses from the rear, [as it were] but truly pious is he who is conscious of God."[109] Emphasising that it is the intention and spirit which are most important, the Prophet reportedly said: "All deeds are according to their intentions."[110] On the occasion of the battle of Banu Qurayẓa in the fifth year of Hijra, the Prophet sent some Companions to the territory of the Banu Qurayẓa (a Jewish tribe residing in Medina at the time) and asked them to pray their *'Aṣr* prayer (late afternoon prayer) on arrival. However, before

103 See Ibn Ḥazm's discussion on *ijmā'* in his *al-Ihkām*.
104 Bello, *The Medieval Islamic Controversy*, p.21.
105 Hasan, *The Early Development*, p.156.
106 Ibid., p.14.
107 Qur'ān 2:177.
108 Asad, *The Message*, p.36.
109 Qur'ān 2:189.
110 Bukhāri, *Saḥīḥ*, I, p.1.

they had reached their destination, the time of prayer came, and some Companions performed the prayer, saying that the Prophet did not mean it to be postponed. Others took the Prophet's order literally and prayed the *'Aṣr* prayer on arrival even though it was nightfall by then. The Prophet approved tacitly the viewpoint of both, which indicates that he did not want them to follow blindly what he asked them to do.[111]

Concluding remarks

The approach of the Religious Supervisory Boards (RSBs) is characterised by a high degree of legalism and *taqlīd* (imitation) of early jurists' opinions. Such an approach to modern banking and finance transactions does not appear to be justified since the *sharī'a* did not restrict the development of commercial institutions explicitly or implicitly but left it to Muslims to develop such institutions as the circumstances dictated, as long as there was no violation of an explicit *sharī'a* rule. We contend that an approach which is based on certain specific *sharī'a* principles would provide the Islamic banker with sufficient flexibility in developing various practices in banking and finance without constantly having to look at the detailed views expressed in *fiqh*. Such an approach would be based on the *sharī'a* principles of equity, justice, fairness and other similar principles as emphasised repeatedly in the Qur'ān and *sunna*, rather than on the basis of a legal opinion or an interpretation of a *sharī'a* text by a scholar of Islam. In order for such an approach to be feasible, there appears to be a great need for an axiological systematisation of the relevant *sharī'a* principles so that Muslim bankers and financiers will be able to judge what is Islamic and what is not, without having to refer to the legist on the particular aspects of each new financial mechanism or transaction.

In conjunction with those stated above and other similar principles, the concept of 'diffusion' could also be utilised by the Islamic banker to develop Islamic banking and finance methods and mechanisms. Diffusion means transfer of cultural elements from one society to another. The process of diffusion invariably accompanies some degree of reinterpretation and change in the elements. By utilising the concept of diffusion, institutions and methods of resource mobilisation and allocation developed in the Western capitalist tradition, can be 'islamised' and assimilated. The utilisation of the concept of diffusion has been advocated by scholars like Husaini (1980), and in a much broader context by the late Faruqi in his program of the islamisation of knowledge. Although criticised by critics like Parvez Manzoor and Ziauddin Sardar, Faruqi's 'islamisation of knowledge' project with its advocating of diffusion, has been the most influential on Muslim social scientists.[112]

Historical evidence also corroborates this stand. Diffusion as a culturally enriching principle was used by the Prophet himself. He assimilated much of the pre-Islamic customs, values and institutions into Islam, by means of diffusion, and a large number of the 'tacit approvals' of the Prophet may fall into this category. After the death of the Prophet, his immediate successors as political leaders used the concept widely. Persian and Byzantine conventions and methods of administration were extensively borrowed to run the vast, newly-conquered regions. In addition to the concept of diffusion, the well established principle in Islamic jurisprudence, "all that is not forbidden by the *sharī'a* is permissible by presumption" gives an open invitation to accept institutions from other cultures. This is in sharp contrast to those who question the very 'islamicity' of financial institutions developed in the capitalist Western world, and borrowed by Muslims, like banks and other financial intermediaries, and argue that Muslims have to establish purely 'Islamic' institutions. The proponents of such views conveniently forget that cross-cultural borrowing is well established in Islamic history and civilisation. The Prophet reportedly said: "A wise counsel is the lost property of the believer, and wherever he finds it he takes hold of it." In this diffusion, consideration must be given to Islamic philosophical, ethical, moral and social principles.

[111] Hasan, *The Early Development* p.14.

[112] Sardar, *Islamic Futures*. pp.85-106.

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CONCLUSION

Modern Islamic banking is based on an interpretation of *riba* which is accepted by various traditional Islamic schools of law. From the 1960s onwards, Islamic banking theorists and practitioners have been engaged in putting this interpretation into practice. Their success in this endeavour is, however, questionable. This study is an initial attempt to question the validity of this interpretation of *riba* and the claims made in the literature for its successful implementation. It is also both an attempt to highlight the moral and humanitarian emphasis given in the Qur'ān and *sunna* to the issue of *riba* and an argument in support of the view that such an emphasis would be valid in the current debate on *riba* and Islamic banking.

Riba and Islamic banks. Examination of the issue of *riba* in the Qur'ān suggests that the Qur'ānic prohibition was based on *moral* and *humanitarian* considerations, not legalistic ones. Investigation into the nature of *riba* as practised in the pre-Islamic period revealed that what was prohibited in the Qur'ān was basically exploitation of the needs of a person in financial difficulty, rather than an 'increase' accruing to the creditor in a loan transaction as such. Such a view is supported by the Qur'ānic comparisons of *riba* with *ṣadaqa* (charity), and also the specific mention of the rationale of prohibition, that is, injustice, in the final verses prohibiting *riba*. The *sunna* had little to say on the nature of *riba* prohibited in the Qur'ān since its focus was on certain forms of sales. The jurists essentially focused on the forms of *riba* prohibited in the *sunna*, almost exclusively building their theory of *riba* thereon, at the expense of developing a theory based on the Qur'ān.

The moral and humanitarian considerations of the Qur'ān in its prohibition of *riba* were not emphasised in the *fiqh* literature, and juristic discussion gradually became more and more legalistic and semantic in nature. *Riba*, as interpreted by the jurists, did not address the issue of peoples' need for borrowing and lending for non-humanitarian purposes. Instead of developing a suitable mechanism for lending for such purposes, the jurists confined the institution of lending (*qarḍ*) to that required solely for humanitarian purposes. Since there was no adequate mechanism in the *sharī'a* to deal with loans for non-humanitarian purposes, and jurists had blocked any redefinition of *qarḍ*, people had to resort to various stratagems in order to lend and borrow. These stratagems, which appear to be largely the invention of jurists, became widely accepted and utilised by Muslims since the need was there, while the stratagems were regarded as lawful by the jurists themselves who were seen to be the guardians of the *sharī'a*. These stratagems enabled

the practising of any form of lending at any rate of interest, and in any circumstances. These stratagems, therefore, had long rendered the traditional interpretation of *riba* almost obsolete.

In the modern period, it is the Modernists who seem to have approached the issue of *riba* and its prohibition in a manner closest to the Qur'ānic 'spirit'. Many Modernists like Fazlur Rahman emphasised the rationale (*ḥikma*) of the Qur'ānic prohibition of *riba*, that is, injustice. However, the Modernist views were regarded by many neo-Revivalist scholars with scepticism and distrust. The neo-Revivalists adopted the traditional interpretation as an immutable ordinance of the *sharī'a*, and have attempted to block any attempt to understand the issue of *riba* from a strictly moral perspective. The neo-Revivalists, who have dominated Islamic thought in the contemporary period, are so zealous in their affirmation of the age-old interpretation of *riba* that Modernist views have been virtually sidelined. From the 1970s onwards, the situation was further complicated by the rise of several conservative states with their petro-dollars to fund Islamic banks and research centres of Islamic banking and finance. Although, for the reasons mentioned here, the Modernists may have had difficulty in having much impact so far on the discussion on *riba*, it is perhaps their approach, particularly that of scholars like Fazlur Rahman, which is promising and which might lead to a radical rethinking of the issue in line with the spirit of the Qur'ān and *sunna*. Such a rethinking is necessary given the enormous difficulties and problems involved in implementing the traditional interpretation of *riba* in the modern period as its usage within the Islamic banking system demonstrates.

Islamic banks and Profit and Loss Sharing (PLS). In implementing the traditional interpretation of *riba*, Islamic banks have attempted to utilise several concepts from Islamic law such as *muḍāraba* and *mushāraka* as the basis for Islamic banking, particularly in their investment operations. The study examined these two concepts briefly to see how they were conceived in the law and then how the banks have applied them. The examination revealed that the experience of Islamic banks with these two concepts has not been satisfactory. Although these originally were meant to be Profit and Loss Sharing (PLS) concepts, Islamic banks soon found that they could not use the concepts as they were developed in Islamic law because they were 'too risk-prone'. The Islamic banks need to be 'Islamic' in the eyes of their clients, as well as 'profitable' in investing in low risk or risk-free ventures for the benefit of these clients and shareholders. The Islamic banks have thus had to strip the two concepts of *muḍāraba* and *mushāraka* of several of their basic characteristics to render them almost risk-free short-term ventures where the bank can advance capital on the basis of a *more or less* predetermined return.

Islamic banks have found out that they cannot be PLS banks but in name. The banks have thus had to divert their attention to risk-free mechanisms developed within Islamic law. The legists and the religious consultants of Islamic banks have been keen to supply the banks with the required material. Soon the terms of *murābaḥa*, *bay' mu'ajjal* (deferred payment sale) and *ijāra* (hire) entered the vocabulary of Islamic banking. Of these we focused on *murābaḥa*. Though *murābaḥa* is not backed by a text of the Qur'ān or a *sunna*, it has been deemed by the legists to be an important mechanism. *Murābaḥa* is a sale on a predetermined return, but even then, the risk-aversion attitude of Islamic banks has necessitated modifying the contract to a risk-free financing mechanism. For instance, several options given by Islamic law to the buyer on a *murābaḥa* basis which were not in the interests of the bank have been systematically eliminated and *murābaḥa*, for all practical purposes, has become a method of financing on the basis of a predetermined return. When looked at from this point of view, it is another modern stratagem (*ḥīla*) utilised in order to practise lending on the basis of interest, which is not unlike its crude sister forms of *ḥiyal* developed in Islamic law in the medieval period. The legists and the religious consultants in one conference after another have provided their sponsoring Islamic banks with various forms of assistance to make *murābaḥa* just like an interest-bearing loan transaction in all but name.

Depositors and Islamic banks. With regard to deposits, in several key areas of the bank-depositor relationship, Islamic banks have taken a stand which indicates that they are perhaps keener to promote their self-interest than to provide the financial intermediary service on the basis of the *sharī'a* principles of justice and equity. Islamic banks have refused to provide any return to the depositors of demand (and similar) deposits although the banks utilise these deposits for their own benefit. These 'cost-free' demand deposits are also not generally provided as interest-free loans as envisaged in the Islamic banking literature. In the case of small savings of low income depositors, the Islamic banks have refused to give any return, even to compensate for the erosion of the value of these savings by inflation. The banks have emphasised that a bank as a *muḍārib* cannot be held liable for the funds. Hence, Islamic banks (whose shareholders' equity is, generally speaking, below ten percent of the total resources available to them), are using the funds of thousands of depositors without being legally liable for any loss. Even in profit distribution, depositors who invest their funds for a shorter term appear to be penalised and are given a lower return than those who can afford to keep their money on deposit longer, a concept which does not appear to have any basis in Islamic law. Of course, most of these policies and practices of Islamic banks are cloaked in legal arguments, and justification is generally based on the views of certain jurists as promulgated by

the Religious Supervisory Boards in their task of ensuring the islamicity of Islamic banking.

Determining what is riba as well as ensuring the islamicity of Islamic banking: the case for ijtihād. The examination of the methods of the RSBs in determining what is Islamic or otherwise in Islamic banking and finance indicates that they constantly refer to the *fiqh* literature to justify or reject modern financial transactions, a method which is hardly justifiable considering the fact that a large number of institutions which we are witnessing in the area of banking and finance are new and did not exist in the early period of Islamic history. Although there is a greater need today to exercise *ijtihād*, perhaps more than ever, the RSBs' method does not indicate that this is happening on a large scale in Islamic banking.

Having examined the traditional interpretation of *riba* in the context of Islamic banking practice, it was perhaps imperative to see what could be done to look afresh at the issue of *riba*. Firstly, a critical analysis of the position of the neo-Revivalists on the issue of *riba* was conducted which highlighted the weaknesses in their position and argued for approaching the issue on the basis of fresh *ijtihād*. Secondly, an argument was advanced to show that such an approach is warranted citing evidence from the foundational texts of Islam as well as Islamic legal theory and history. The analyses indicated that rulings in the two primary sources of the *sharī'a*, namely the Qur'ān and *sunna*, were flexible enough to allow the development of the various institutions a Muslim society needs on the basis of *equity* and *justice*. It also indicated that there is ample evidence to suggest that a reappraisal of the issue of *riba* is not only possible but should be the norm given the position of the leading Companions and early authorities on *ijtihād* and the importance many of them placed on the underlying reasons for any given command or prohibition.

Since the traditional interpretation of *riba* as advocated by the neo-Revivalists does not appear to be justifiable, it is imperative to look at the question from a broader perspective in the light of the moral principles of the *sharī'a* such as fairness, justice and equity. From this perspective, within the context of banking and financial transactions, it would be the injustice factor which would ultimately determine what is *riba* and what is not. An 'increase' in a financial transaction given to the creditor just because it is an increase would not be *riba*. This, applied to modern bank interest, would mean that not all forms of interest are *riba*, but only those forms which involve injustice to one of the contracting parties. Therefore, any interest-based transaction which involves injustice should be prohibited as *riba*. Similarly, a transaction, even though it may not involve an explicit interest component but leads to injustice to one party, may be regarded as a *riba* transaction. The point to be made here is that it is the circumstances of a particular transaction, the parties to such a transaction, the rela-

tive power of the parties vis-à-vis each other as well as the economic and social environment within which the transaction takes place, which should determine whether a particular transaction should be prohibited as *riba*.

The practice of Islamic banks reveals that they have been unable to eradicate interest from their transactions, which is practised under various guises and names. Neither is there good reason to believe that Islamic economists have developed a method of finance which is free from interest and at the same time practical enough to be the basis of a modern banking system. Therefore it is perhaps time to take a realistic look at *riba*. In banking, perhaps it is not enough to have the label 'Islamic', to be an Islamic bank. First and foremost, the institution, whether it be called 'Islamic' or otherwise, needs to be a more humane one, enabling people to have access to funds on humane terms, and at a suitable cost. It is this form of banking which is needed to help raise the standard of living of the peoples of the Muslim world, many of whom are living below the poverty line.

GLOSSARY

ahl al-ḥadīth	Traditionists.
aḥādīth	pl. of *ḥadīth*.
aḥkām	pl of *ḥukm*.
ajīr	worker on the basis of a wage.
ajr	wages, reward.
Allah	God.
amīn	one worthy of having a trust placed on him; one possessing character and integrity.
asbāb al-nuzūl	occasions of the revelation of Qur'ānic verses.
aṣl	root; formal legal source; principle of jurisprudence (eg. the Qur'ān, *sunna*, *qiyās* or *ijmā'*). In *qiyās* it is also used to denote the original case from which the deduction is made.
āḥād	isolated. A *ḥadīth* that although it does not ensure certainty of belief its genuineness is sufficiently guaranteed to base a rule of law thereon. They are not recognised by all leading jurists.
āyāt	verses of the Qur'ān.
'ālim	man of learning; scholar of religion.
'amal	practice.
'ibādāt	devotional duties and acts towards God.
'ibāda	worship.
'idda	waiting period.
'illa	the effective cause, the connecting link in an analogy (*qiyās*).
'inān	in Ḥanafi law, a partial investment partnership involving only mutual agency and not mutual suretyship on the relations between the partners; in Māliki law, a partnership limited either to a single commodity or a single transaction.
'īna	a form of fictitious sale utilised mainly to lend on the basis of interest.
'ulamā'	pl. of *'ālim*.
'urf	custom, usage.
barni dates	a form of dates.
bay' mu'ajjal	deferred payment sale.
bay'	sale.
biḍā'a	see *ibḍā'*.
Companions	immediate followers of Prophet Muḥammad who witnessed his mission, had at least met him person-

ally and died as Muslims. Sometimes they are referred to as the first generation of Muslims.

dayn debt, loan.

dhahab gold.

dinar gold unit of currency used in early Islam.

dirham silver unit of currency used in early Islam.

ḍa'īf weak, defective.

ḍamān guarantee.

ḍarar injury, damage.

ḍarūra necessity.

fals designation of the copper coin current in the early centuries of Islam.

faqīh one learned in *fiqh (Islamic law)*

farḍ the obligation; the duty ordered by God.

fatwa decision or formal opinion given on a judicial or legal question.

fiḍḍa silver.

fiqh the science of understanding of divinely-revealed law; science of the *sharī'a;* Islamic jurisprudence; Islamic positive or substantive law.

fuqahā' jurists; legists; experts on Islamic law.

hijra the emigration (from Mecca to Medina) of the Prophet; the beginning of the Islamic era.

ḥāja need.

ḥadīth sayings, deeds or tacit approvals of Prophet Muḥammad; a recorded tradition of a precept or action of the Prophet.

ḥajj the pilgrimage to Mecca.

ḥarām forbidden by the *sharī'a.*

ḥikma rationale; underlying reason.

ḥiyal stratagems; legal devices; evasions for the purpose of circumventing, not violating, provisions of Islamic law.

ḥīla a stratagem.

ḥukm command; law; the *sharī'a* value.

ibḍā' type of informal commercial collaboration on which one party entrusts his goods to the care of another, usually to be sold, after which the latter, without any compensation, commission, or profit, returns the proceeds of the transaction to the first party.

ijāra hire or lease contract.

ijmā' al-umma consensus of the Community.

ijmā' consensus of Islamic scholars on a point of Islamic law; one of the four principles of jurisprudence in the Sunni schools of law.

ijmā' qawli an *ijmā'* evidenced by speech.

ijmā' sukūti an *ijmā'* evidenced by the silent assent of the generality of the *mujtahids* to the *ijtihād* of the few *mujtahids* who have expressed a disciplined judgment; consensus based on silent assent.

ijtihād exerting oneself to the utmost degree to understand through disciplined judgment. The interpretation of one considered competent to understand *sharī'a*; systematic original thinking; private expert opinion on questions of Islamic law.

imām leader of the Muslim community or a group within the Muslim community, in prayer or in intellectual thought.

infāq spending.

isnād chain of authorities in a *ḥadīth.*

isrāf extravagance.

īmān faith.

jāhiliyya pre-Islamic period.

jahāla want of knowledge; uncertainty.

Jamā'at Islāmi Islamic Party founded by the well known Pakistani scholar Abu al-A'la Mawdūdi.

jihād struggle, holy war.

jins genus.

kāfir one who is guilty of unbelief.

kafāla muṭlaqa absolute guarantee.

kufr concealing, ingratitude, unbelief.

māl ribawi any item susceptible to *riba.*

madhāhib pl. of *madhhab.*

madhhab school of law.

makīl measurable.

mashhūr well-known, famous, a tradition vouched for by more than two companions.

maṣlaḥa public interest; interest.

matn text of a *ḥadīth*

mawqūf ḥadīth a *ḥadīth* which is not attributed directly to the Prophet.

mu'min believer in God.

mu'āmalāt transactions, rules regulating the relationship between human beings.

mu'āmala shar'iyya (see *mu'āmala*).

mu'āmala transaction. Sometimes a *ḥīla* (strategem) relating to *riba* is called *mu'āmala shar'iyya* (a legal transaction).

muḍāraba (alternatively known as *qiraḍ* or *muqāraḍa*) arrangement in which one party invests capital and another party trades with it on the understanding that they share the profits on an agreed upon ratio, and that any

	loss resulting from normal trading activity is borne by the investor.
muḍāraba muṭlaqa	absolute *muḍāraba.*
muḍārib	the party who provides his skill and labour in a *muḍāraba* contract and manages the *muḍāraba.*
mufassirūn	exegetes.
mufti	one considered competent to give a legal decision on a question asked or a *fatwa*; expert on Islamic law who gives a legal opinion.
mujaddid	a Renewer; appellation given to those great Muslims who, through the centuries, have rendered signal services to the cause of Islam.
mujmal	ambiguous; not explicit.
mujtahid	one accepted as competent to exercise *ijtihād.*
muqāraḍa	Māliki and Shāfi'i term for *muḍāraba*
muqallid	one who practises *taqlīd.*
murābaḥa	resale of goods with the addition of a fixed surcharge to the stated original cost.
mushāraka	partnership.
mushrik	one who is guilty of *shirk.*
mut'a	temporary marriage.
mutawātir	a tradition reported by numerous authorities; proved by universal testimony.
muṭma'inn	tranquil.
najsh	collusion.
naqdiyya	the characteristic of being money.
nasī'a	deferment (see *riba al-nasī'a*)
naskh	repeal.
nuṣūs	pl. of *naṣṣ.*
qafīz	a measure that is four times the quantity [of corn etc] that fills the two hands (that are neither large nor small) of a man.
qarḍ ḥasan	a *ribā*-free loan.
qarḍ	loan of money or other fungible objects intended to be consumed.
qirāḍ	Māliki and Shāfi'i term for *muḍāraba.*
qiyās	analogy; one of the principles of Islamic jurisprudence.
ra's al-māl	capital or principal.
ra'y	opinion, with the significance of independent reasoning as applied to the legal method of the Ḥanafi school; an opinion, point of view, idea, which is arbitrary when used in contrast to *ijtihād*, but calm and unprejudiced when used in contrast to *hawā'.*
rabb al-māl	capital provider (investor) in a *muḍāraba* contract.
riba	generally translated as usury or interest.

riba al-faḍl	*riba* which occurs as a result of an increase in one of the countervalues in a transaction involving two similar commodities susceptible to *riba.*
riba al-jāhiliyya	*riba* which was practised in the pre-Islamic period.
riba al-jali	*riba* prohibited in the Qur'ān, according to Ibn Qayyim.
riba al-khafi	*riba* prohibited in the *sunna*, according to Ibn Qayyim.
riba al-nasī'a	*riba* which occurs as a result of a deferment of one countervalue in a transaction involving two commodities susceptible to *riba.*
riba al-qarḍ	*riba* related to loans.
ribḥ	profit; it is also be used at times for interest in a loan transaction.
Salafiyya	Islamic purificationist movement calling for a return to true Islam as practised by the early pious generation (*salaf*).
salam	form of sale entailing advance payment for future delivery.
sharā'i'	pl. of *sharī'a.*
sharika	partnership (business).
sharikat 'inān fi al-māl	a form of partnership which is termed as limited investment partnership.
sharī'a	Islamic fundamental law based on the Qur'ān and *sunna*; divinely-revealed law.
Shaykh al-Islām	highest religious authority in the Ottoman Empire.
sūra	chapter of the Qur'ān.
sunna	the traditions of the Prophet Muḥammad; what he said, did, or approved tacitly; the model behaviour of the Prophet; *ḥadīth.*
ṣā'	a certain measure used (originally) for measuring corn.
ṣadaqa	charity; voluntary spending
ṣaḥīḥ	authentic, and sound; used in the classification of *ḥadīth.*
ṣalāt	the five daily prayers.
ṣaraf	money exchange.
tafsīr	commentary and explanation of the Qur'ān.
taqlīd	imitation; the following of the opinion of another without investigating that other's reasons.
taqrīr	a kind of *sunna*; what the Prophet Muḥammad implicitly approved or tolerated of the customs and cultures of his time.
umma	community; nation; the people; the Muslim community.

uṣūl al-fiqh	principles of Islamic jurisprudence, or the science of Islamic jurisprudence.
uṣūl	pl. of *aṣl* (principle).
wadī'a	deposit.
wuḍū'	ablution.
zakāt	a form of tax levied on Muslims for the relief of poverty, etc.

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